D&O Glossary

Directors & Officers (D&O) Liability and Insurance Glossary

Willis

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For further information, contact:

Ann Longmore
Senior Vice President
Telephone: 212 837 0788
Email: longmore_an@willis.com

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American depositary receipts (ADRs): Traded on US exchanges by non-US companies wishing to list on a US exchange. They're called receipts because they represent a certain number of a company's regular shares.

Aggregate limit of liability: The total amount that an insurer will pay under a policy for defense costs, settlements and judgments. This amount is not increased by the number of claims made under the policy, the number of insureds who seek payment under the policy, or otherwise. The retention or deductible is not included or added in to the aggregate limit of liability. Any retention or deductible on the policy must be spent by the insured before any payment will be due under the policy.

Allocation: A determination of the portion of a loss that is considered to be covered by an insurance policy when less than 100 percent of the loss is covered. Allocation issues arise when certain of the defendants in a claim are insureds under an insurance policy and certain are not, or when certain of the allegations or wrongful acts in a claim are insured and certain are not. Allocation means determining which portion of a loss arising from a claim will be *allocated* to the insurance policy (or payable by the insurer) and which portion will not. Allocation issues most often arise when both an entity and its insured directors and officers are named in a suit, but the entity is not covered by the policy. In that instance, some portion of loss arising from defense costs, settlement or judgment is considered incurred by the entity and therefore not reimbursable under the policy. There has been a substantial amount of litigation regarding the issue of allocation and as a result, most D&O carriers now offer entity coverage in some form, or contractually agree to a pre-set allocation.

Application – main form: A main form application for D&O insurance asks for all pertinent information about the company applying for insurance, including financial information about the company and any subsidiaries, identification of all directors and officers to be covered, current insurance information and claims history, among other things. The most significant feature of a main form application is that it expressly asks about potential claims or circumstances that could lead to claims and requires that the signatory essentially warrants (on behalf of all potential insureds) that no such potential claims or circumstances exist. (If potential claims or circumstances are indicated on the main form application, the insurance typically would not cover those potential claims or circumstances). For D&O policies that do not provide severability in regard to the application, if it is later determined that any potential insured knew or should have known that a potential claim or circumstance likely to lead to a claim did exist at the time the main form application was signed, the insurer has the right to seek rescission of the entire policy, as to all insureds, which renders the policy void *ab initio* (or from the beginning). See also the definition of Severability.

Application – renewal: A renewal application is typically shorter than a main form application and does not require that the signatory provide a warranty that no potential claims or circumstances exist.

A-side coverage: Coverage for the directors and officers when the company does not indemnify them for the costs of defense, settlement amounts, or judgments against them. Companies almost always indemnify their directors and officers, and therefore, B-side coverage is most often utilized. A-side coverage generally has little or no retention or deductible, because many individuals cannot afford to pay out of their own pockets. Some states do require that a minimal retention or deductible be charged. Some D&O policies indicate that A-Side Coverage is only available if the entity is not permitted by law to indemnify. The policy presumes that if permitted to do so, the company will indemnify. Accordingly, if the company can indemnify but chooses not to, some insurers will argue that A-Side Coverage is still not implicated, and that coverage is

only available on the B-Side (with the retention or deductible from the B-Side being applicable). See also Presumptive indemnification.

B-side coverage: Reimbursement coverage under a D&O policy that pays the company back for amounts it pays out on behalf of its directors and officers for defense costs, settlement amounts or judgments. Most D&O claims fall under the B-side of the policy, since most companies indemnify their directors and officers. The B-side of the policy usually has a retention or deductible that bears some relationship to the amount of money that the company can afford to pay out of its own pocket before seeking insurance reimbursement.

Capacity or insured capacity or covered capacity: The role or position of the insured individual in a D&O claim when acts at issue occurred (or are alleged to have occurred). Under a D&O policy, directors and officers are insured for acts taken in their *capacity* as directors or officers. If an individual who happens to be an officer of a company is sued because of his behavior while on vacation (unrelated to work), he was not acting in his capacity as an officer and thus, would not have the benefit of his D&O policy to protect him from that suit. Capacity issues can arise when an individual acts in more than one capacity, such as being an officer and a shareholder, or being a lawyer for the company, while at the same time acting as an officer or director.

Claim: What constitutes a claim has been the subject of much coverage litigation. Some D&O policies now include a definition of a claim so as to avoid any uncertainty. Obviously, lawsuits are claims if duly noticed to the insurer. The definition of a claim, or lack of definition, becomes an issue when something less than a lawsuit occurs. For example, does a complaining or threatening letter from a shareholder constitute a claim? This becomes relevant in several ways. First, the insured may not consider such a letter to be a claim and therefore provides no notice of it, makes no reference to it in renewal discussions, and then when a lawsuit is actually filed, finds out that the insurer believes that it was already a claim that should have been noticed under a prior policy, or referenced on a renewal application, and denies coverage. It can also be relevant if the insured wants to settle with the complainer before a lawsuit is initiated, but the insurer does not believe that it rises to the level of a claim, and thus denies coverage.

Claims-made: A claims-made policy is one that covers claims that are first made or asserted during the pendency of the policy, without regard to when the acts giving rise to the claim occurred, unless the policy specifically excludes claims arising from acts that occurred prior to a certain identified date. The opposite of a claims-made policy is an occurrence policy, which provides coverage for claims, whenever they are asserted, if they complain of acts that occurred during the policy period. There are no time limitations on an occurrence policy as to when the claim must be asserted. As a result, occurrence policies are significantly more expensive. Insurers on occurrence policies have no certain date by which they can figure out whether a policy was profitable because they do not know when, if ever, a claim might be asserted that alleges wrongful acts during the period of the occurrence policy.

Claims-made and reported: A claims-made and reported policy is a claims-made policy that specifically requires that any claim made during the policy period also be reported to the insurer during the policy period. D&O policies are usually very specific as to when the insured must provide notice to the insurer of a claim and the notice requirements are typically identified as a condition precedent to coverage. This means that complying with the notice provision is the first hurdle that must be passed before you even consider whether the claim is otherwise covered. Most D&O policies are claims-made and reported policies, although over the last couple of years, the requirements on the timing of notice have been softening. Many policies now require notice as soon as practicable during the policy period or for some identified period (e.g., 90 days) after the end of the policy period.

Co-defendant coverage: Protection for individuals or entities that would otherwise not be covered by a D&O policy, as long as at least one insured under the policy is also named as a defendant in the same suit at the same time.

Co-insurance: The percentage of all loss that is the company's or the insured's sole responsibility, throughout the pendency of a claim. Sometimes co-insurance applies only to defense costs, or only to settlements and judgments, but usually it applies across the board. Many D&O policies do not contain co-insurance. Some states require some minimum amount of co-insurance. If a policy contains a simple co-insurance feature that applies to all loss, including defense costs, then that is the percentage of each dollar spent that the company or the insureds must pay.

Combination or combined policy: See multi-line policy.

Continuity: Continuous coverage without gaps. The issue of continuity arises when an insured switches insurers. The insured needs to know that there will be no gap in coverage for wrongful acts that occur prior to the inception date of the policy that do not result in a claim until after the new policy has incepted. Some insurers in the past put wrongful acts dates on new policies that precluded coverage for acts that occurred prior to the inception date. Now when an insured is considering switching insurers, the broker needs to address continuity to ensure that there will be no gap in coverage. In the current market, most insurers will agree to provide continuity.

Coverage coordination: The attempt to address potential or actual overlaps in coverage between two or more insurance policies. For example, when a claim against an insured could impact a D&O policy and an Employment Practices or Fiduciary Liability policy, this potential overlap needs to be addressed so that the insured is not left in the middle of a coverage coordination fight between the insurers of the different policy lines all pointing at the other as having primary responsibility for the claim. This can be addressed in advance by identifying at least one of the policies as primary, which would mean that if there is any possibility of coverage under that policy, it takes responsibility for the claim. Another consideration is to purchase all coverages that have this potential for overlap from the same carrier. In that way, the insurer cannot point the finger at another company.

Deductible: Under a D&O policy, the terms deductible and retention are interchangeable and mean the amount of covered loss that the company has to pay before the policy will come into play. It should be stressed that these terms are NOT interchangeable on other types of insurance. In the case of D&O policies, the deductible or retention only applies to covered loss. Accordingly, if there is an allocation because some part of the claim is not covered by the policy (See: Allocation), then the allocation must be determined before the deductible or retention is subtracted. Say, for example, several defendants are sued, some of which are insured under a D&O policy. It costs $5 million to defend and settle the suit and the insurer and insured agree to allocate 50 percent of the costs of defense and settlement to the insureds. Since the deductible or retention only applies to "covered loss", the allocation must occur before the deductible or retention is applied. In this case, the allocation results in $2.5 million being covered by the insurance. After the deductible or retention of $500,000 is applied to the covered loss, the insurer should pay the remaining $2 million.

Defense outside the limits: D&O policies are generally defense within limits policies. That means that all costs and expenses incurred in the defense of the claim and payable by the insurer reduce the aggregate limit of liability of the policy. Accordingly, if an insured has a $10 million policy, and spends $2 million on defense costs alone, there is only $8 million left to satisfy a settlement or judgment, or deal with other claims. Defense Outside Limits provides a substantial expansion of coverage to the insured because the amount expended in defense of claims does not reduce the limit of liability of the policy. Thus, the limit remains intact for payment of settlements and judgments, regardless of the costs of defense. Few D&O insurers are willing to agree to defense outside limits.

Discovery: Also referred to as an extended reporting period. An additional period of time specified in the insurance policy that occurs after the end of the policy period. The insured can "elect" or notify the insurer that it wants to exercise this option, which will cost the insured an additional premium. The policy itself will define the length of this additional period and the cost (which is usually a percentage of the premium paid for the policy). The purpose of this additional period is to give the insured additional time to report claims. Note that the discovery or extended reporting period does not have its own limits of liability but instead, is an extension of the limit of liability in place immediately prior to the election of discovery. Sometimes the right to discovery (or an extended reporting period) is triggered by a particular occurrence, such as a non-renewal of the policy by the insurer. Insureds that renew with the same insurer usually do not have the option of electing discovery. The historic purpose of discovery was to make sure that when changing insurers, an insured did not lose coverage between the expiration date of the old and the inception date of the new policy. This is less of a concern today because many insurers will now give continuity, which protects the insured for acts that occurred prior to the inception date of its policy. Insureds now elect discovery when they have reason to believe that a wrongful act which might lead to a claim has occurred and they want that claim, if it is made, to be handled under the non-renewed policy.

Duty-to-defend: The obligations of the insurer to appoint counsel, develop and implement defense strategy, and generally take care of a claim against an insured. D&O policies for publicly-traded companies are not duty-to-defend policies. Fiduciary liability policies usually are duty-to-defend; employment practices policies may be. The fact that D&O policies are not duty-to-defend policies means that it is the insured's responsibility to retain its own defense counsel and make its own defense decisions. Even without a defense obligation, the insurer is nonetheless entitled to participate in the defense of a claim covered by the D&O policy. Different insurers want to participate to different degrees. Most D&O policies now contain the right of the insurer to "effectively associate" in the defense and settlement of a claim. See: effective association.

Effective association: This term is used by insurers to stress the amount of participation that they desire in the claims handling process. By effective association, the insurer is attempting to say that its input in developing defense strategy in all its phases must be substantial. The insurer wants to have a say in motion practice, trial strategy and settlement negotiations. Effective association means something more than keeping the insurer informed of the progress of the claim, but something less that having an actual duty to defend. This term has not been examined in any detail by a court to date.

Employment practices claim: Usually, this means a claim by an employee against his or her employer (or prospective or former employer) and perhaps against other individuals employed by the employer. Separate policies are sold that specifically address these types of claims and each such policy has its own definition. D&O policies often now include an exception in the insured versus insured exclusion for wrongful termination claims, which is an employment practices claim. Some D&O insurers will also add an endorsement to a D&O policy which specifically adds employment practices coverage. These types of endorsements usually also include what that insurer believes to be an employment practices claim. Note that an endorsement on a D&O policy extends the policy to provide that coverage, but it is usually subject to the terms and conditions of the D&O policy and subject to its limit of liability and retention. Employment practices claims are usually defined to include, as a minimum, wrongful termination, failure to promote, breach of employment contract, discrimination and harassment.

Endorsement: A separately negotiated clause in the insurance contract that is not considered part of the main form or boilerplate of the policy. Endorsements are added to modify or amend the boilerplate. Many insurers have standard required endorsements that must go on every account and are not considered negotiable. This usually occurs when the insurer needs to update its boilerplate form but has not done so yet. Unfortunately, some insurers amend their boilerplate and do not include these mandatory (by the insurer's standards) endorsements. Most states also require certain amendatory endorsements, usually dealing with cancellation, renewal and discovery.

Entity coverage: Coverage under a D&O policy for the direct liability of the company. Historically, no entity coverage was provided by a D&O policy. The purpose of the policy was specifically to protect the directors and officers from the risk of personal liability. Usually, the company for which the directors and officers worked also wanted to protect them and agreed to indemnify them subject to reimbursement by the D&O insurer. Because the company was typically named in a suit with its directors and officers, however, a dispute arose over what portion of defense costs, settlement amounts or judgments was properly credited to the directors and officers and thus, covered under the D&O policy, and what portion was properly credited to the company, and thus, not covered. This led to arguments over allocation (see allocation) and has now resulted in new D&O policy forms that expressly address either entity coverage or allocation.

Excess insurance: Companies who want a substantial amount of D&O coverage may not be able to get it all from a single insurer. In that case, companies will buy insurance from more than one insurer and each insurer will have a different attachment point at which time their insurance may be implicated by a claim. The first insurer is usually referred to as the primary insurer, although the policy itself typically does not identify itself as such. Excess policies are generally triggered only after the primary insurer has paid, committed to pay, or is otherwise obligated to pay, its full primary limits. Excess policies are usually identified as such, and usually follow the form of the primary policy. Therefore, the primary insurer has more input in the handling of a claim. The excess insurer will often want to be notified of a claim but does not necessarily want to get too involved until such time as the claim appears likely to exceed the primary insurance. Excess policies need to be examined carefully in regard to notice requirements and in regard to the amount of information that the excess carrier wants from the insured.

Extended reporting period: See: Discovery.

Follow form: This term is usually used in an excess policy and means that the excess policy incorporates by reference all of the provisions of the primary policy, except as may be specifically changed in the excess policy itself.

Hammer clause: This is typically found in the defense section of a D&O policy and is the result of the insured's right to consent to a settlement. Most D&O policies give the insured the right to consent, and therefore, to withhold consent, to a settlement. However, the insurer wants to be protected in those instances where it wants to settle a claim so as to limit its liability and the claimant is agreeable, but the insured refuses. In such an instance, the hammer clause generally states that the insurer's liability is limited to that amount for which the case could have been settled, plus defense costs incurred up to the date that the claim could have been settled. In the event that the insured's refusal to settle ends up costing more money (i.e., the case is settled for more later, or results in a judgment for more, or simply more defense costs are incurred) then the insurer is not liable for those additional amounts.

Some insurers are now willing to delete the hammer clause altogether, or to modify it to provide some further coverage.

Insured versus insured exclusion: Also referred to as one v. one exclusion and I v. I exclusion. This exclusion is found on virtually all D&O policies and precludes coverage for claims by one insured under the policy against another insured under the policy. This exclusion is intended to preclude collusive suits between insureds (i.e., you sue me, my insurance will pay, and we will split the recovery) but it is not limited to collusive suits. Any suit by an insured against another insured is precluded from coverage. There are also standard caveats to this standard exclusion. The first exception is for derivative suits, as long as the company and the policy insureds do not provide any active assistance to the derivative suit. This exception is necessary because derivative suits are exactly the kind of suit for which insureds seek coverage, but they are brought "on behalf of" or in the right of the company. The second standard exception is for wrongful termination suits brought by former officers of the company. Note that this exception does not work for wrongful termination suits by directors (primarily because directors are not particularly likely to bring such a suit). The third exception is less standard and allows coverage for

cross claims or indemnity claims by other insureds, as long as the cross claim or indemnity claim would otherwise be covered by the policy.

Interrelated wrongful acts: Most D&O policies include a definition of what is interrelated wrongful acts because the insurers want all such interrelated acts that result in claims to be dealt with at one time. This means that if more than one claim is asserted that alleges the same or similar acts, then even if the claims are not consolidated by their respective courts, they will be treated by the insurer as if they were consolidated into a single claim.

Initial public offering (IPO): Refers to the first time a company sells stock to the public. An IPO is a type of a primary offering, which occurs whenever a company sells new stock, and differs from a secondary offering, which is the public sale of previously issued securities, often held by insiders.

Multi-line policy: This type of policy provides more than one kind of insurance coverage. For example, D&O insurance may be sold in tandem with Fiduciary Liability insurance, Employment Practices Liability insurance, or practically any other kind of insurance. In the past, multi-line policies were either the result of stapling together several different policies and affixing a single declarations page on top, or a complete rewrite that attempted to incorporate the different types of insurance in some semblance of order and consistency. These days, several major insurers offer standard multi-line policies, and many insurers are willing to consider writing a special multi-line policy that includes whatever line of insurance the insured wants.

Multi-year policy: Most D&O policies are for a one-year period, which commits both insurer and insured to that timeframe. Many insurers are willing to offer a multi-year program that commits the insurer for a longer period. Multi-year policies usually have automatic renewals with set premiums and basically no changes to the wordings.

Notice of facts or circumstances: Most D&O policies allow insureds to provide notice of facts or circumstances that they reasonably believe might result in claims against them. This is essentially the right to provide notice of potential claims. Usually, providing notice of facts or circumstances is within the discretion of the insured – the policy does not require it. However, if an insured desires to provide such notice, then the policy will require some element of specificity. A notice to the insurer that the insured is always at risk that someone might sue is insufficient. The idea behind notice of facts and circumstances is to ensure that, if the facts and circumstances do result in a claim, that claim will be covered.

Other insurance clause: All D&O policies contain “other insurance clauses” intended to indicate that if other insurance applies to a claim, then the other insurance applies first. These clauses are widely quoted in coverage coordination disputes. Courts, however, have often found that the policies in question are equivalent and, all other coverage issues being equal, the policies should attach on a proportionate basis. Courts vary as to whether this proportionate basis should be determined by differing limits of liability, some kind of policy analysis the court believes to be the most applicable, or simply a 50/50 split.

Outside directorship coverage: This is an extension of coverage to include claims against a director or officer for acts taken in the officer’s or director’s capacity as a director of another company, as long as the officer or director is acting in that “outside” director capacity at the request of his or her employer. Since most D&O policies automatically include coverage for subsidiaries, this extension of coverage does not apply to acts as a director of a subsidiary. Companies may ask their own directors or officers to act as directors on unrelated outside company boards because of a particular business deal in the works, to protect a security interest, to enhance a business relationship, or for any number of other reasons. Outside directorship coverage is usually on a “double excess” basis, which means that the insurance will apply as excess over the outside company’s indemnification obligations and then excess over the outside company’s insurance.

Presumptive indemnification: The insurer presumes that the company will indemnify its directors and officers to the fullest extent allowed by law. The D&O insurer not only hopes that the company will take care of its directors and officers in the event of a claim, it wants to come as close as possible to requiring it. There are two primary reasons for this: the first is that the insurer wants the company to have a stake in the litigation so that the company will use its best efforts to resolve the litigation in a reasonable manner. The second is that the company can better afford to pay defense costs until such time as the policy retention or deductible has been spent. Most D&O policies now have low retentions for claims against directors and officers that are not being indemnified by the company or no retention at all.

Primary insurance: Insurance designated as primary is usually considered the first insurance to be applied in connection with a claim. Many comprehensive general liability policies specifically indicate that they are primary. Insurance is considered primary, though not specifically designated as such, when it is the first insurance over an uninsured retention or deductible. Excess policies written over the first policy will typically refer to the first policy as the primary policy.

Private Securities Litigation Reform Act of 1995 (SRA): Essentially tort reform for federal securities litigation. The Act took effect in 1996 and was designed to eliminate frivolous securities litigation by tightening the rules relating to *scienter* (or knowledge), limiting the number of cases where any one individual could be the lead plaintiff, asserting that the lead plaintiff was the individual/entity with the greatest financial stake in the case, setting out the methodology for measuring loss and eliminating joint and several liability for underwriters, accountants and others. In the short run, the result was to further concentrate federal securities litigation in the hands of the Milberg, Weiss firm, and to increase the size of D&O settlements that survived the average motion to dismiss.

Proxy: A written authorization by a shareholder for another person to represent him/her at a shareholders' meeting and exercise voting rights.

Reinsurance: This is a business mechanism used by insurers to pass on some of the risk they are underwriting – it is essentially insurance for the insurer. Reinsurance is not available directly to the insured.

Rescission: As in securities parlance, this means undoing a transaction so that each side to the transaction is back to where they started before the transaction took place. In the D&O insurance context, an insurer attempting to rescind wants to negate a policy, as if it never existed, by giving the insured its premium back. Rescission is an extreme remedy that is not often asserted. Proving a basis for rescission differs from state to state but generally requires that the insurer be able to show that the insured made material misrepresentations regarding the risk being insured and that, without those misrepresentations, the insurer would not have issued the policy.

Retention: See Deductible.

Retroactive date: D&O policies with retroactive dates, or retro dates, provide coverage for wrongful acts that occurred any time back to the retroactive date, but not for wrongful acts that occurred before that date. A retro date is used when a company acquires a subsidiary. The acquisition date is often the retro date for that subsidiary, because the company does not want to provide coverage for claims alleging wrongful acts that occurred at the subsidiary before it became a subsidiary. Some insurers identify the retro date as the inception date of the first D&O policy issued by the insurer to the insured. Not all D&O policies include retroactive dates.

Road show: A tour taken by a company preparing for an IPO in order to attract interest in the investment. Attended by institutional investors, analysts and money managers by invitation only. Members of the media are forbidden.

Run-off: A D&O policy automatically converts into a "run-off" policy when there has been a change in control of the company, or the company ceases to exist. Most D&O policies contain a changes clause, or a termination clause, which indicates that once a change in control has occurred, then coverage will for claims arising from wrongful acts that occurred prior to the change in control, but no coverage will be provided for acts which occurred after the change in control. A company selling a subsidiary often agrees to maintain coverage for the directors and officers of the subsidiary for acts that occurred during the time that the entity was a subsidiary. The acquiring company will obtain its own insurance for all acts that occur after it has taken control of the company. In such a case, the acquiring company will often require that the selling company purchase run-off coverage for some set period, such as five years, to protect the directors and officers for acts taken when they were a part of the selling company.

S-1: Document filed with the Securities and Exchange Commission announcing a company's intent to go public. Includes the prospectus; also called the *registration statement*.

Sarbanes-Oxley Act (SOX): Legislation enacted in response to the corporate governance and financial scandals of 2002. Its goal was to heighten corporate responsibility and transparency.

Securities claim: Securities claims, those claims related to shareholder value, are the most severe of all D&O claims, and also have a high frequency level. Securities claims were not historically defined in D&O policies. However, with allocation decisions making the insurer responsible for the bulk of the defense and settlement costs on any claim asserted against both the directors and officers and the entity, some insurers decided to address allocation by specifically defining a securities claim and then specifically providing entity coverage for that type of claim. Most D&O policies today define a securities claim so that some coverage is provided. Definitions vary among the different carriers, with the broadest being any claim brought by a stockholder.

Severability: In the D&O context, severability means that the wrongful acts or misstatements of one insured will not void the contract or otherwise adversely impact coverage thereunder for other insureds. Severability typically comes up in two ways: severability for the exclusions and severability for the application.

Severability of the exclusions means that if the conduct of one insured implicates an exclusion in the policy (for example, the personal profiting exclusion) coverage may be denied to that individual insured but coverage for other insureds will not be denied. Most D&O policies automatically include a statement about severability either at the beginning or end of the exclusions section, or directly underneath the exclusions relating to wrongful conduct.

Severability of the application means that if the individual who signed the application and/or any warranties made a material misstatement or misrepresentation in order to induce the insurer to issue the policy, that individual's misstatement or misrepresentation will not void the coverage for the other insureds. Some D&O policies automatically provide severability of the application. Other insurers are typically willing to consider providing severability.

Spousal extension: Extends coverage to spouses of directors and officers who are sued solely because of their position as a spouse. Spouses run the risk of being sued primarily in community property states where a judgment against a married director or officer would not be fully collectible because his or her spouse has a significant ownership interest in the assets of director or officer. Spousal extensions expressly do not provide coverage for claims against a spouse alleging wrongful acts by the spouse.

Territory: The geographic scope of coverage. Unless the policy says otherwise, coverage under the policy is not limited to any particular area. Some D&O policies limit coverage to only those claims asserted or only those acts allegedly committed, in the United States of America, its possessions and territories, and Canada.

Wells notice: A preliminary decision by SEC staff recommending civil action.