

# D&O Liability: How Exposed Are You?

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**From #MeToo to cyber risk exposure, emerging areas of vulnerability are fueling increase in both the volume of shareholder claims and the difficulty of defending them.**





**M**ost boards, and the board members who serve on them, associate director and officer liability risk with financial impropriety—and for good reason. Over the past decade, securities lawsuits primarily focused on financial or accounting misrepresentations.

That, however, is no longer the case, Carrie Kennedy, vice president and eastern management liability leader at commercial insurer CNA, told board members participating in a roundtable discussion co-sponsored by CNA and AHT Insurance.

“What we’re looking at now is more event-driven litigation,” she explained. “Basically, that means a company experiences some sort of adverse event that is either disclosed by the company or becomes publicly known. That event has an impact on the stock price, and then shareholders bring a suit.”

Examples abound. Just weeks after the California wildfires, plaintiff attorneys acting on behalf of shareholders filed securities litigation against both Edison International and PSE&G after reports suggesting company facilities caused the fires. The suits anticipated a financial impact that had yet to emerge. Marriott International faced a similar response within days of disclosing a cyber breach related to its acquisition of Starwood. #MeToo scandals also prompted lawsuits at a rash of companies, including 21st Century Fox, Nike and Google, that alleged board members were aware of issues like sexual harassment, a hostile environment or gender pay disparity and failed to take steps to address them.

Further complicating the D&O litigation landscape, an increasing number of cases are coming in the form of

shareholder derivative class actions rather than securities class actions. “In a derivative action, shareholders bring a suit on behalf of the company,” explained Dennis Gustafson, principal at the insurance brokerage and consulting firm AHT Insurance, who noted that the 21st Century Fox, Nike and Google lawsuits were all derivative class actions.

“The shareholders essentially say, ‘I’m bringing a lawsuit against you, the individual director, on behalf of the company because you didn’t do what you were supposed to in order to prevent or address this behavior.’”



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**—Carrie Kennedy,  
CNA Insurance**

### **The Director D&O Dilemma**

With more lawsuits coming from more quarters and in more forms, it’s little wonder that directors and officers are increasingly concerned about understanding their vulnerability to litigation and the details of insurance policies that guard it. Roundtable attendee Doug Prince, a director at Senseonics, expressed interest in an “update on D&O trends” and guarding against “potential holes in coverage we may have.” Gina Wilson, a director at Conduent, cited “having read so much about [cyber risks] the last several months” as prompting her interest in gaining a better understanding of cyber and D&O insurance.

Recent regulatory activity underscores the need for concern over cyber-related liability. A host of cyber-related regulations that penalize companies for not adequately safeguarding consumer information or for using data inappropriately have been passed over the past two years,

including the California Consumer Privacy Act, the New York Department of Financial Services Cybersecurity Regulation and the EU’s General Data Protection Regulation. In their

wake, Facebook, Cambridge Analytica, Yahoo, Google, Marriott International and others have all been targeted with cyber-related securities suits.

Since no cybersecurity initiative can offer 100 percent protection, cyber-related litigation may seem inevitable. However, companies that take steps to mitigate risk and develop a post-breach protocol, as well as to document those efforts, may have a better chance of fending off suits. We see examples of companies battling lengthy D&O claims stemming from a cyber breach that they failed to disclose in a timely manner. Meanwhile, other companies of similar size that also suffered a breach have their D&O litigation dismissed, possibly at least in part because they were able to document that discussions about cyber controls, cybersecurity and cyber insurance took place during consecutive quarterly board meetings for years prior.

“You should be talking on a quarterly basis about cybersecurity, cyber insurance or cyber controls,” Kennedy advised directors. “And whenever the word ‘cyber’ comes up in the boardroom, make sure you document that in your minutes to show that you’re talking about it. It will help you to demonstrate that you’re being proactive in the event of a claim.”

### Proactive on Policies

Several participants also expressed concern about the lack of control directors have over the policies that protect them. “Most of us are not involved heavily in the conversation about what policies are being bought,” noted Leigh Epperson, a director at Comenity Capital Bank, pointing out that directors like her have little control over policy details. “That’s usually the general counsel or someone else at the company.”

There are ways, however, that directors can be proactive about checking on their companies’ process for gauging coverage needs, noted Gustafson, who urged directors to devote a little time to learning about the fundamentals of D&O insurance, such as the three sections and what each one covers [see table below]. It’s also a good idea to pay attention to the process the company follows to decide on coverage levels.

“My advice is, you have every right to ask, ‘What are our limits? And how do we determine what the appropriate limits are—what data did we use?’” he said, adding that the process should involve multiple data points. “If the answer is a single data point, then you should ask, ‘What else can we use to compare and contrast this?’”

## D&O Basic Insuring Clauses

D&O liability policies are broken down into three basic coverage sections:

<div><div><b>A</b></div><div><b>Personal Asset Protection</b></div><div><b>Claim Against</b> Individuals</div><div><b>Responds When</b> Company is unable to financially or legally indemnify its individuals</div><div><b>Retention</b> No</div><div><b>Clause A</b> The section of the policy is for claims made against individual directors, officers and employees of the company. It offers personal asset protection for the individuals. This coverage provision is for non-indemnifiable loss only. These are claims where the company cannot legally or financially indemnify its individuals. This could occur during bankruptcy [financially unable] or for a derivative suit [legally unable]. New coverage enhancements are also now advising defense cost to individuals when the company wrongfully or rightfully refuses to indemnify.</div></div>	<div><div><b>B</b></div><div><b>Balance Sheet Protection</b></div><div><b>Claim Against</b> Individuals</div><div><b>Responds When</b> Company has satisfied its policy retention for indemnifiable loss against individuals</div><div><b>Retention</b> Yes</div><div><b>Clause B</b> This section of the policy is for claims made against individual directors, officers and employees of the company where the company can and will indemnify. It offers balance sheet protection to the entity. This coverage provision is for indemnifiable loss only and is first subject to the applicable retention.</div></div>	<div><div><b>C</b></div><div><b>Balance Sheet Protection</b></div><div><b>Claim Against</b> The Company</div><div><b>Responds When</b> Company is named in a securities claim</div><div><b>Retention</b> Yes</div><div><b>Clause C</b> The section of the policy is for claims made against the company directly. It also offers balance sheet protection to the entity. The coverage provision is commonly for securities claims only and is subject to the applicable policy retention.</div></div>
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Ideally, if directors are concerned about the possibility of increased liability, their companies will explore an increase in the section of D&O insurance known as Clause A or Side A coverage. “We have seen an increase in Side A insurance in the current environment,” reported Kennedy. “I imagine a lot of astute directors are going to their companies and saying, ‘You should be buying more side A insurance.’” Personal director insurance, or insurance purchased directly by individual directors for themselves, is also an option.

Today’s director liability landscape is challenging for insurers as well, Kennedy added, pointing out that the actuarial approach that insurers typically use to gauge risk in order to compute policy rates is difficult to apply to some of the emerging areas of litigation, which defy quantification. “For example, we as D&O insurers are just as interested as your investors and stakeholders in what you’re doing regarding your corporate culture—that it’s not about winning at all costs—and in making sure that the tone at the top translates to the tone at the middle and the tone at the bottom,” she said. “Because



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**—Dennis Gustafson,  
AHT Insurance**

oftentimes, where we see issues is that the tone at the top looks fantastic, but it is not institutionalized throughout the organization. It’s becoming a differentiating factor for us with the companies we insure, driven by not only #MeToo but also the fact that corporate culture translates to good business practices in general.”

At the same time, insurers are realistic about the boundaries of a board’s role in driving a company’s culture. “Obviously, it’s not the board’s responsibility to set the culture,” said Kennedy. “I’m sure that it can feel to directors as if shareholders are looking for perfection and the slightest misstep is just going to result in litigation,” she said. “But I really do think shareholders and institutional investors are looking for companies to have just asked the questions and had the discussions that they probably should have been having all along.”

The bottom line? As expectations of boards and board accountability continue to intensify, today’s directors face an increasingly complicated and potentially risky D&O liability landscape—one they may want to take a more proactive stance on navigating.

## About AHT Insurance

AHT Insurance is a full-service insurance brokerage and consulting firm offering property and casualty, employee benefits, retirement, private client and international services for clients throughout the United States and 42 other countries. Supporting numerous industries and boasting national recognition in the technology, manufacturing, government contracting and nonprofit practice areas, AHT offers clients highly customized solutions to identify and help mitigate risks they may face. As an employee owned firm, AHT’s professionals have the stability and latitude to put clients’ needs first and focus on what they do best—providing best-in-class service and solutions. [www.ahtins.com](http://www.ahtins.com)



## About CNA

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