Understanding Five D&O Risk Factors

Boards of directors and executive officers of organizations of every kind take risks daily in their efforts to run a successful business.

Many of those risks are known before they are taken, while some are taken without the full appreciation of what the ripple effects may be. While lawsuits brought against public companies by shareholders often receive the most attention, civil (and criminal) actions can be brought just as easily against individuals in leadership positions at private companies and nonprofit organizations.

How businesses and organizations manage, mitigate and transfer risk effectively is a multilayered process. Companies can utilize management liability policies, specifically Directors & Officers Liability Insurance (D&O), as a cost-effective tool to transfer certain risks off their respective balance sheets and provide comfort to directors and officers that the decisions they make as stewards of the business are protected to the fullest extent allowable under corporate bylaws and legal standards.

Five significant areas impacting and creating risk for boards and executive decision makers are:

- Workforce
- Governmental and regulatory authorities
- Marketplace/vendors and customers
- Creditors
- Investors

WORKFORCE

It often surprises leaders of organizations that a significant percentage of claims made against them can emanate from their own workforce. If employees have brought forward concerns about mistreatment to their superiors and feel those concerns have gone unaddressed, they may resort to the courts or various state and federal agencies for intervention and relief. While these claims are not pure D&O claims, they are covered under the broader universe of management liability policies, namely employment practices liability insurance (EPL). Typical allegations in employment practices claims against companies, fellow employees and directors and officers include, but are not limited to:

- Wrongful dismissal
- Discrimination and harassment (gender, age, race)
- Workplace retaliation
- Pay equity gaps

GOVERNMENT AND REGULATORY AUTHORITIES

Governmental and regulatory authorities' purposes are varied and sometimes not easily understood; however, one pursuit that they all share is to protect the interests of citizenry and ensure a fair playing field exists for all parties, companies and consumers alike. Some regulators have broad jurisdiction, like states' attorneys general or the U.S. Department of Justice, while others have a more focused role, like the U.S. Food and Drug Administration. All play a crucial role in ensuring that organizations and their officers conduct activities in a fair and lawful manner.

Regulatory oversight takes shape in a wide array of laws and codes, including but not limited to:

- Corporate law: Governing the ownership and management of organizations.
- Securities law: Governing the administration of publicly listed companies.
- Consumer protection law: Governing the distribution of products and services to consumers.
- Occupational health and safety law: Ensuring organizations maintain a safe workplace.
- Taxation law: Governing the taxation of organizations and individuals.
- Environmental law: Ensuring adherence to environmental restrictions by industry participants.

If regulators uncover wrongful conduct, civil and sometimes criminal action may be pursued against both the organization and the executives involved.

MARKETPLACE

Balancing corporate growth to drive returns to investors or partners must be balanced with regulatory compliance and fair-trade practices. Alleged failure to do both can result in crippling legal costs that could cause the underpinnings of an otherwise responsible board or executive management team to collapse.

Directors and officers may be named in legal actions that allege many different acts of corporate malfeasance. Some recurring claim theories include, but are not limited to:

- Breaches of intellectual property
- Misappropriation of trade secrets
- Collusion
- Anti-competitive behavior

ADDITIONALLY, DIRECTORS AND OFFICERS MAY FIND THEMSELVES HELD ACCOUNTABLE FOR ACTIONS PERCEIVED AS MISLEADING OR DEFAMATORY, POTENTIALLY LEADING TO CLAIMANTS SEEKING DAMAGES FOR PERCEIVED LOSSES.

CREDITORS

The leadership group of every organization is responsible for ensuring its financial health and well-being, including the ability of the firm to service all debt obligations over the course of time. In the event of organizational insolvency, creditors frequently scrutinize the decisions made by directors and officers to ascribe accountability and breaches of duty by executives, which would potentially allow them to see remediation in bankruptcy court.

When debts remain unpaid during an organizational liquidation, creditors may individually pursue executives in an effort to recover outstanding funds.

Typical allegations by creditors against directors and officers encompass:

- Breach of fiduciary duty
- Breach of duty of care
- Negligence
- Deliberate misconduct

INVESTORS

The Friedman Doctrine, introduced by Milton Friedman in the 1970s, states that a business's sole responsibility is to create profits for its investors. While that belief may not be held by all investors in today's day and age, it does serve as bedrock for many corporate boards and the decisions they make. Investors — individual and corporate alike — are motivated to invest in companies based on track records of performance; that is, companies that generate financial gain for its investor base.

With substantial financial interests on the line, shareholders that feel the value of their assets (i.e., their holdings in the company) may take steps to safeguard their investment if they are dissatisfied with the organization's trajectory. Should an investor or group of investors come to believe that management has violated their responsibilities to the detriment of the organization, investors may initiate a claim against the one of or many of the directors alleging any or all of the following:

- Mismanagement, including alleged employment law torts
- Breach of duty
- Violations of federal or state securities laws
- Breach of duty of care

THE LANDSCAPE OF RISK FACED BY DIRECTORS AND OFFICERS IS MULTIFACETED, COMPLEX AND NUANCED ALL AT THE SAME TIME.

Whether operating as a non-profit, privately held or public company, the potential financial impact of legal challenges can be significant, affecting both the organization and its executives. To mitigate these risks, management liability insurance products — and D&O insurance, specifically — are a vital tool, offering protection for individuals in leadership roles and the organization itself.

HOW CAN ALLIANT HELP?

Our team brings specialized technical, legal, underwriting and claims experience on all types of executive risk exposures. We take the time to learn about your specific business requirements, exposures and risk appetite and then leverage deep insight into the D&O insurance marketplace to tailor a program that provides the best and most appropriate protection for you.

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