

Insuring Your Business: Knowing and Managing Your Risk

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Topics for Discussion

- **Directors and Officers Liability Policies**
 - Coverage in the #metoo Era
 - Cyber Security
- **Additional Insured Coverage**
- **First-Party Property Coverage**

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Directors and Officers Liability Insurance

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What Are D&O Policies?

- D&O policies cover a company's directors and officers against claims for their alleged "wrongful acts."

- *Gateway Grp. Advantage, Inc. v. McCarthy*, 300 F. Supp. 2d 236, 243 (D. Mass. 2003) (citation omitted).

"Although the wording of particular policies may vary, the typical definition does indeed cover more than what one commonly thinks of as mere negligence: misstatement, misleading shareholders, regulators or the public, foolishly overcompensating an incompetent CEO, refusing to rein in the CFO's rampant sexual harassment of subordinates and so on.' Thus, D & O policies are generally 'thought to cover the insureds for things that go beyond mere oversight' but do 'not go so far as to provide coverage for specifically unintended illegality or intentionally inflicted harm or looting of the corporate entity."

What Are D&O Policies?

- Types of coverage that may be provided:
 - Coverage for claims against individual directors and officers for acts and omissions in their role as directors and officers where the company will not or is not permitted to indemnify them
 - Reimbursement of the company for losses it suffered because of claims against directors and officers (*e.g.*, where the company paid indemnification)
 - Coverage for securities claims (*e.g.*, shareholder derivative lawsuits)
- Other coverage forms that may be included:
 - Employment Practices Liability Insurance
 - Crisis Management/Media Relations Coverage
 - Select First-Party Coverages

The Impact of #metoo

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Why Are D&O Policies So Important in the #metoo Era?

- Companies may be held vicariously liable for Title VII claims for sexual harassment committed by individuals.
- Companies may be held liable for failing to put in place policies and to adequately respond to claims.
- Shareholders don't like losing their money to claim payments and judgments.

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Real Life Examples

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Roger Ailes, Bill O'Reilly, and Twenty-First Century Fox, Inc.

- Allegations that the board of directors breached its fiduciary duty to shareholders by failing to respond to sexual harassment claims and lawsuits at Fox News
- For example, Fox News renewed Bill O'Reilly's contract just weeks after it settled three sexual harassment claims against him
- \$90 million settlement

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Harvey Weinstein and The Weinstein Company

- The board and the company were made aware of 3 or 4 confidential payouts to women accusers when Weinstein's contract was up for renewal in 2015
- *Fed. Ins. Co. v. Weinstein*, Case No. 1:18-cv-02526 in the USDC for the Southern District of New York
 - At a minimum, Mr. Weinstein wants to be defended against sexual harassment claims under the EPL coverage form
 - Third-party complaint filed against The Weinstein Company's D&O and EPL insurer, National Union Fire Insurance Co. of Pittsburgh, PA

Dr. Larry Nassar, USA Gymnastics, and Michigan State University



<https://www.hbo.com/video/documentaries/at-the-heart-of-gold/videos/amanda-thomashow-clip>

Dr. Larry Nassar, USA Gymnastics, and Michigan State University

- Allegations that USA Gymnastics and university officials knew about Dr. Nassar's misconduct and did nothing
 - *Mich. State Univ. v. Ironshore Specialty Ins. Co.*, Case No. 19 000494-CB, Ingham County, Michigan Circuit Court
 - *USA Gymnastics v. Ace Am. Ins. Co.*, currently Case No. 1:19-ap-50012 before the United States Bankruptcy Court for the Southern District of Indiana
- MSU agreed to \$500 million settlement in November 2018

Summary

- Employment claims are expensive and may have more wide-reaching consequences than originally anticipated.
- The #metoo movement is leading to increased claims relating to corporate management.
- If you're a smaller company without an extensive corporate structure, at least consider Employment Practices Liability Insurance.

Cyber Security

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Why a Data Breach May Trigger a D&O Policy

- Focus on whether directors and officers failed to take adequate steps to prevent a breach of the company's cyber security defenses
- Liability consequences:
 - Shareholder derivative lawsuits and class actions
 - Regulatory investigations and imposition of fines
 - Criminal investigations, such as if stock is sold before news of the data breach is made public

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Recent Cases

- Yahoo!
 - Between 1 and 3 billion Yahoo! users' names, telephone numbers, dates of birth, and encrypted passwords affected by a 2013 data security breach
 - A separate data breach in 2014 exposed 500 million users' information
 - *In re Yahoo! Inc. Securities Litigation*, USDC Northern District of California Case No. 5:17-CV-00373-LHK
 - \$80 million settlement
 - *In re Yahoo! Inc. Shareholder Litigation*, Santa Clara County, California Superior Court No. 17-CV-307054
 - \$29 million settlement paid for by Yahoo!'s and Verizon's insurers
 - The SEC also fined Altaba, Yahoo!'s successor-in-interest, \$35 million for the two-year disclosure delay

Recent Cases

- Unsuccessful shareholder derivative lawsuits
 - *Palkon v. Holmes*, USDC District of New Jersey Case No. 2:14-CV-01234 (SRC): Wyndham Worldwide Corporation
 - *Davis v. Steinhafel*, USDC District of Minnesota Case No. 14-CV-203 (PAM/JJK): Target Corporation
 - *In re The Home Depot, Inc. Shareholder Derivative Litigation*, USDC Northern District of Georgia Case No. 1:15-CV-2999-TWT

First-Party Data Breach Coverage

SECTION A - COVERAGES DATA BREACH EXPENSES

1. Insuring Agreement

a. We will pay for "data breach expenses" that you incur as a result of a "data breach" of "personally identifiable information" to which this insurance applies. The amount we pay for "data breach expenses" is subject to a deductible and limited as described in Section C – Limits Of Insurance And Deductible.

No other obligation or liability to pay sums or perform acts or services is covered.

b. This insurance applies to "data breach expenses" only if:

(1) The "data breach" involves "personally identifiable information" that is:

(a) Held by you or on your behalf in the United States of America (including its territories and possessions), Puerto Rico or Canada; or

(b) Stored in a laptop, notebook, netbook, smartphone, tablet or other similar electronic data storage device when such device is taken outside of the territory described in subparagraph (a) above by you or an employee on a business trip of ten (10) or fewer days duration;

(2) The "data breach" occurs on or after the "retroactive date" and before the end of the "policy period";

(3) The insured first becomes aware of the "data breach" during the "policy period";

(4) At the time you applied for this insurance you had no knowledge of the "data breach"; and

(5) The "data breach" is reported to us as soon as practicable, but in no event later than thirty (30) days after it is first discovered by the insured.

Summary

- Have a plan to protect against a data breach and a plan about what to do if one happens.
- Don't hide a data breach from your shareholders.
- This is the Information Age, and hacking is a fact of life. If you don't have a few million dollars to throw away, assure your insurance policy extends to data breaches.

Additional Insured Coverage

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What Is Additional Insured Coverage?

- It makes a party other than you an insured under your insurance policy.
- It shifts the financial burden of paying for a covered loss (and any resulting increased premiums) to another party.
- It can be found in the Who Is An Insured clause and/or in an endorsement.

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What Is Not Additional Insured Coverage?

- Do not confuse additional insured coverage with an indemnity agreement.
 - Additional insured coverage is insurance. An indemnity agreement is a transfer of risk.
 - An indemnity agreement may require the indemnitor to be responsible for the indemnitee's sole negligence, if permitted by law.
 - *But see* Kan. Stat. Ann. § 16-121; Mo. Rev. Stat. § 434.100.
 - Don't forget about the Contractual Liability Exclusion.

Common Areas of Additional Insured Coverage

- Under the Who Is An Insured clause
 - Executive officers, members, employees, real estate managers, and permissive users
- By endorsement
 - Construction
 - Landlord-Tenant
 - Other Lessor-Lessee Relationships
 - Franchisor/Vendor/Subcontractor Relationships
 - Transportation of Goods/Freight

Avoiding Hard Lessons About Additional Insured Coverage After a Loss

- A written contract or agreement is necessary; ***never*** depend on an oral agreement
 - There is some wiggle room about what is a written contract or agreement.
 - *Thunder Basin Coal Co., L.L.C. v. Zurich Am. Ins. Co.*, 969 F. Supp. 2d 1134, 1142–43 (E.D. Mo. 2013) (applying Wyoming law).
 - *KB Home Tucson, Inc. v. Charter Oak Fire Ins. Co.*, 236 Ariz. 326, 330, 340 P.3d 405 (Ct. App. 2014).

Avoiding Hard Lessons About Additional Insured Coverage After a Loss

- The written contract must specify that additional insured coverage is primary and non-contributory.
 - *Navigators Ins. Co. v. N. Builders, Inc.*, No. 1-12-2479, 2013 IL App (1st) 122479-U, ¶¶ 24–25 (May 14, 2013):

“The first sentence in West Bend’s AI Endorsement states that “[t]his insurance is excess over: Any other valid and collectible insurance available to the additional insured whether primary, excess, contingent or any other basis unless a written contract specifically requires that this insurance be either primary or primary and non-contributing. This first sentence addresses when the West Bend policy will be excess insurance coverage available to Northern Builders as an additional insured. There exists a contract between Northern Builders and Arlington that requires Arlington to name Northern Builders as an additional insured and requires that the coverage be primary. ... We cannot rule that West Bend’s policy as applied to Northern Builders is excess coverage, as it has invited us to do, without ignoring the first sentence of the endorsement. ... We agree ... that West Bend’s insurance policy provides primary coverage for Northern Builders as an additional insured.”

Avoiding Hard Lessons About Additional Insured Coverage After a Loss

- When setting the amount of additional insured coverage, consider specifying that the entire amount must be in a primary policy, as opposed to an excess or umbrella policy.
 - If some of the limits are provided through an excess or umbrella policy, the additional insured may run the risk of being subject to horizontal exhaustion or the mutual repugnance doctrine.

Avoiding Hard Lessons About Additional Insured Coverage After a Loss

Pro Tip: Never accept a certificate of insurance as proof of additional insured coverage. Get the policy and read it.

Pekin Ins. Co. v. Am. Country Ins. Co., 213 Ill. App. 3d 543, 548, 572 N.E.2d 1112 (1991) (emphasis in original):

“... [T]he certificate specifically stated that any contract for which the certificate was issued was ‘*subject to all of the terms, exclusions, and conditions of such policies.*’

...

... [T]he certificate in this case only served to inform Ulbrich that it had the same insurance coverage that the primary insured had ...

...

... [T]he plaintiff was advised to look to the policy to ascertain the nature and extent of coverage. We conclude that it was also Ulbrich’s responsibility rather than American Country’s to determine whether this coverage was adequate for its intended purpose. To hold otherwise would place an excessive burden on insurers ...”

Additional Insured Causation Standards: *Three Types*

1

“Arising out of”

2

“Caused, in whole or in part”

3

Vicarious liability

“Arising Out Of”

ADDITIONAL INSURED – OWNERS, LESSEES OR CONTRACTORS – COMPLETED OPERATIONS

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name of Person or Organization: AS REQUIRED BY WRITTEN CONTRACT
Location And Description of Completed Operations: BLANKET
Additional Premium: INCLUDED

(If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.)

Section II – Who Is An Insured is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of “your work” at the location designated and described in the schedule of this endorsement performed for that insured and included in the “products-completed operations hazard”.

“Arising Out Of”

- It is a “but for” standard, meaning that the named insured does not have to be directly negligent. The named insured’s operations, work, etc. merely must be a cause of injury.

Cincinnati Ins. Co. v. Mo. Highways & Transp. Comm’n, No. 4:12-CV-01484-NKL, 2014 WL 4594207, at *12 (W.D. Mo. Sept. 15, 2014) (citations omitted).

“[U]nder Missouri insurance law, ‘arising out of’ has been interpreted ‘to be a very broad, general and comprehensive phrase’ meaning ‘originating from’ or ‘having its origins in’ or ‘growing out of’ or ‘flowing from.’ ... This language is ‘more expansive than the words ‘caused by’ used in some policies,’ and requires only ‘a simple causal relationship’ between the injury and the activity of the insured, as opposed to ‘the strict ‘direct and proximate cause’ standard of general tort law.’ Accordingly, Missouri courts have held that but-for causation is ‘sufficient to satisfy the ‘arising out of language’ in policies.’”

“Caused, In Whole Or In Part”

ADDITIONAL INSURED INCLUDING PRIMARY/NON-CONTRIBUTORY WORDING – OWNERS, LESSEES OR CONTRACTORS – SCHEDULED PERSON OR ORGANIZATION

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE FORM

SCHEDULE

Name Of Additional Insured Person(s) Or Organization(s):	Location(s) Of Covered Operations
BLANKET WHERE REQUIRED BY CONTRACT	

...

A. Section II – Who Is An Insured is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury” ... caused, in whole or in part, by:

1. Your acts or omissions; or
2. The acts or omissions of those acting on your behalf;

in the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

“Caused, In Whole Or In Part”

- Generally requires a proximate cause standard, meaning that the named insured’s negligence must be ***the*** cause of the injury.
- Proximate causation may mean as little as 1% liability assessed to the named insured.
 - *Capital City Real Estate, LLC v. Certain Underwriters at Lloyd’s London*, 788 F.3d 375, 380 (4th Cir. 2015).
 - *Jones Lang LaSalle Ams., Inc. v. PK Welding LLC*, No. 16-02804 (WHW)(CLW), 2017 WL 2712941, at *6 (D.N.J. June 22, 2017).

Vicarious Liability

- These endorsements generally will not provide additional insured coverage if the additional insured is solely negligent.
- Vicarious liability is the least seen endorsement language. Many endorsements attempting to use this standard have been found unenforceable.
 - *See Md. Cas. Co. v. Regis Ins. Co.*, No. CIV.A. 96-CV-1790, 1997 WL 164268, at *6 (E.D. Pa. Apr. 9, 1997) (“only with respect to liability sought to be imposed upon the Additional Insured as the result of an alleged act or omission of the Named Insured” unenforceable).
 - *But see BP Chems. Inc. v. First State Ins. Co.*, 226 F.3d 420, 425–27 (6th Cir. 2000) (applying Texas law, and finding “EXCLUD[ED] ANY NEGLIGENT ACTS COMMITTED BY SUCH ADDITIONAL INSURED” enforceable).

Summary

- Carefully negotiate additional insured coverage on the front end. It may save you a lot of attorneys' fees later.
- Carefully review the additional insured coverage once bound to assure it conforms to the negotiations. It may save you a lot of attorneys' fees later.
- "Arising out of" coverage favors the additional insured, whereas vicarious liability favors the named insured.

First-Party Property Insurance Coverage

What Does It Cover?

- Real property damage
- Personal property damage
- Loss of income
- Extra expenses

Real and Personal Property Damage

- Replacement cost value versus actual cash value
 - Actual cash value is the value after depreciation
 - Replacement cost value is what it costs to repair or replace with reasonably similar materials
- Insurance company will only pay actual cash value until submission of receipts for what repairs or replacements actually cost
- RCV is time-limited—usually 180 days after the loss—unless you advise the insurer of the intent to make an RCV claim before the deadline runs

Water Losses

- A property policy is not flood insurance.
- Coverage for water damage is typically very limited.
- Sewer back-up coverage is typically added by endorsement.

Water Exclusion

Water

1. Flood, surface water, waves (including tidal wave and tsunami), tides, tidal water, overflow of any body of water, or spray from any of these, all whether or not driven by wind (including storm surge);
 2. Mudslide or mudflow;
 3. Water that backs up or overflows or is otherwise discharged from a sewer, drain, sump, sump pump or related equipment;
 4. Water under the ground surface pressing on, or flowing or seeping through:
 - a. Foundations, walls, floors or paved surfaces;
 - b. Basements, whether paved or not; or
 - c. Doors, windows or other openings; or
 5. Waterborne material carried or otherwise moved by any of the water referred to in Paragraphs 1., 3. or 4., or material carried or otherwise moved by mudslide or mudflow.
- This exclusion applies regardless of whether any of the above, in Paragraphs 1. through 5., is caused by an act of nature or is otherwise caused. An example of a situation to which this exclusion applies is the situation where a dam, levee, seawall or other boundary or containment system fails in whole or in part, for any reason, to contain the water.

But if any of the above, in Paragraphs 1. through 5., results in fire, explosion or sprinkler leakage, we will pay for the loss or damage caused by that fire, explosion or sprinkler leakage (if sprinkler leakage is a Covered Cause of Loss).

Fire Losses

- Mo. Rev. Stat. § 379.140: the valued policy statute.

“In all suits brought upon policies of insurance against loss or damage by fire hereafter issued or renewed, the defendant shall not be permitted to deny that the property insured thereby was worth at the time of the issuing of the policy the full amount insured therein on said property; and in case of total loss of the property insured, the measure of damage shall be the amount for which the same was insured, less whatever depreciation in value, below the amount for which the property is insured, the property may have sustained between the time of issuing the policy and the time of the loss, and the burden of proving such depreciation shall be upon the defendant; and in case of partial loss, the measure of damage shall be that portion of the value of the whole property insured, ascertained in the manner prescribed in this chapter, which the part injured or destroyed bears to the whole property insured.”

- *Norwood-Redfield Apartments Ltd. P’ship v. Am. Family Mut. Ins. Co.*, No. 18-2618, 2019 WL 2158369 (8th Cir. May 16, 2019).

Business Income

- Typically requires a “necessary suspension” of operations, *i.e.*, a total cessation of business. *See Somerset Indus., Inc. v. Lexington Ins. Co.*, 639 F. Supp. 2d 532, 542 (E.D. Pa. 2009) (citation omitted).
 - Check the policy definitions, which may be broader than total cessation.
- “Necessary suspension” typically limits coverage to the location where the loss happened. *See Lavoie Corp., Inc. v. Nat’l Fire Ins. of Hartford*, 293 Ga. App. 142, 145, 666 S.E.2d 387 (2008). Make sure to purchase coverage for all locations.

Extra Expenses

- Typically, there is no financial ceiling. There is only a time limitation.
- Expenses must be necessary. They will not be covered if an insured “incur[s them] on a gratuitous or voluntary basis.” *Chatham Corp. v. Dann Ins. Co.*, 351 Ill. App. 3d 353, 359, 812 N.E.2d 483, 285 Ill. Dec. 663 (2004).

Summary

- Evaluate how your business’ geographic location and facility age and equipment could cause or contribute to a loss that interrupts or stops your business operations. Evaluate what obligations you would have to other manufacturers and customers if you couldn’t do business as usual.
- Talk with your insurance agent about whether your business is missing property coverages for the first-party risks that are keeping you up at night.

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