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#MeToo: Is Your Company Covered?

A year ago, sexual assault allegations against movie mogul Harvey Weinstein rocked the entertainment industry and quickly led to the rise of the #MeToo movement, sparking an upsurge of reports and claims of sexual harassment in workplaces across America. In many cases, the alleged misconduct is not new. But the intensity, tone, and tenor of the claims — and the sheer volume of allegations — has been dramatically different and has had significant effects on businesses caught in the cross-hairs.

Public sentiment has also shifted: A CNN poll conducted in December 2017 found that nearly 70% of Americans described sexual harassment as a "very serious problem." That's almost double the 36% of Americans who expressed similar views in a CNN/Time poll conducted in 1998. As high-profile, credible women have come forward in virtually every industry, more women have been emboldened to share their stories.

Alleged perpetrators are not the only ones being called to account; so are other corporate actors who allegedly enabled, covered up, or failed to prevent the wrongdoing. Sexual harassment claims against high-ranking corporate actors can expose companies to enormous costs, including reputational harm, consumer boycotts, drops in market capitalization, loss of corporate opportunities, and legal expenses for internal investigations, government proceedings, employment lawsuits, securities class actions, and shareholder derivative suits.

It's vital that businesses and individual directors and officers understand their potential exposure to loss arising out of sexual misconduct claims and the availability and limitations of their insurance coverage.

Employment Claims

Sexual harassment charges filed by employees with the Equal Employment Opportunity Commission (EEOC) increased 13.6% in fiscal year 2018 (October 2017 through September 2018) from the year before. The number of sexual harassment lawsuits brought by the EEOC itself also increased by more than 50%. Anecdotally, employers and insurers have reported an increase in internal complaints and attorney demand letters alleging sexual harassment.

Management and settlement of claims, however, may be getting more expensive and complicated, partly due to new laws designed to discourage or prevent non-disclosure provisions in settlement agreements and mandatory arbitration of harassment claims.

Non-Disclosure Provisions

The Tax Cuts and Jobs Act of 2017 prohibits employers from taking tax deductions for sexual harassment claim settlements and related attorneys' fees if those agreements contain non-disclosure provisions. Employers are required to choose between demanding confidentiality and losing the deduction, or facing potential publicity. This could result in fewer settlements and drive more litigation of harassment claims.

Congress is also considering the Ending the Monopoly of Power over Workplace Harassment through Education and Reporting Act, which would prohibit employers from requiring a non-disclosure or non-disparagement agreement addressing workplace harassment as a condition of employment. Parties would still be permitted to include a confidentiality provision in an agreement to settle a harassment claim, if they both agree.

States have also taken steps to address the confidentiality issue. New York and California, for instance, now prohibit employers from requiring non-disclosure provisions in agreements to settle harassment claims and allow victims to decide whether to voluntarily agree to such a provision. Other states, such as New Jersey and Pennsylvania, have proposed similar legislation.

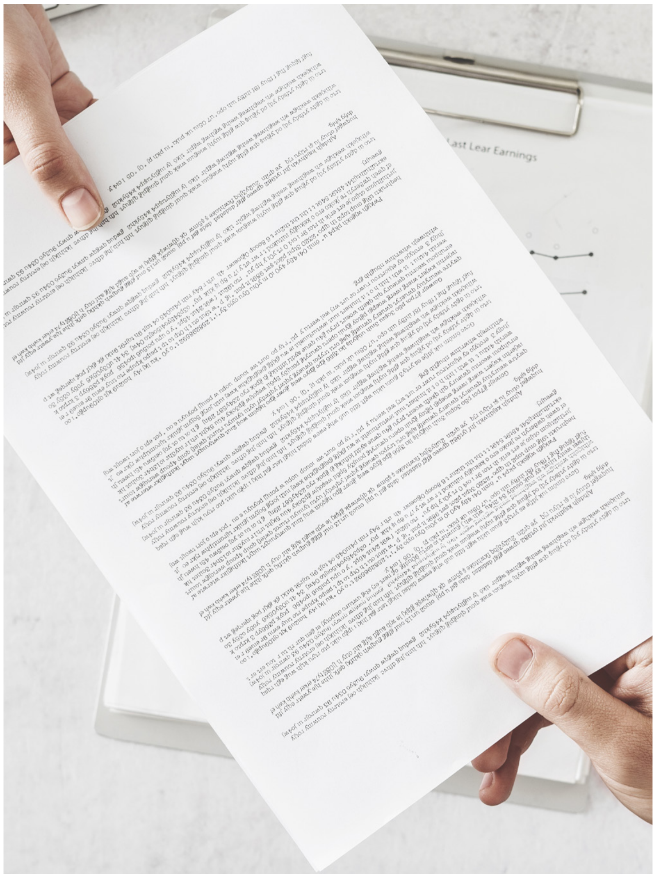
Mandatory Arbitration Agreements

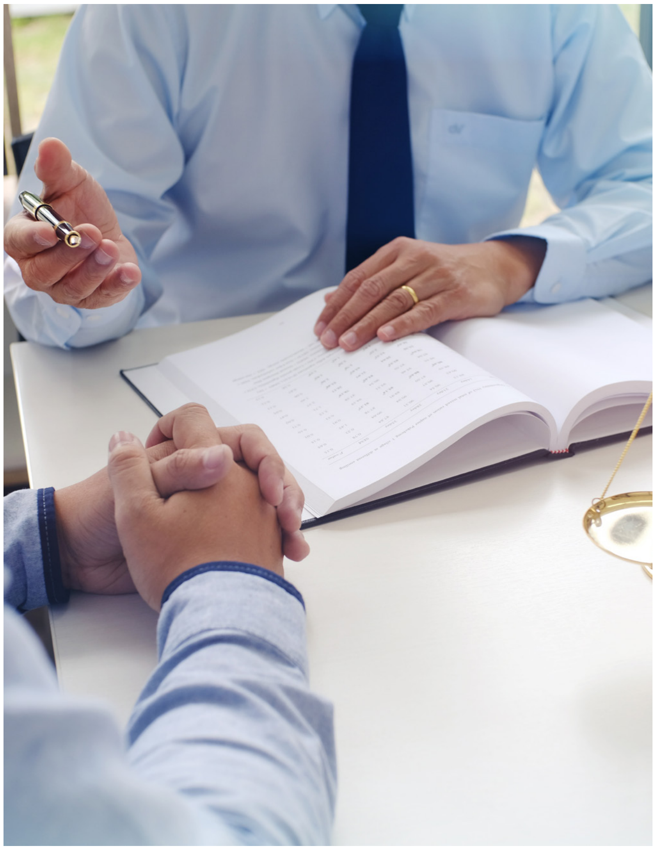
Many employers impose mandatory arbitration agreements prohibiting employees from filing sexual harassment claims in court and compelling arbitration as a condition of employment. The Ending Forced Arbitration of Sexual Harassment Act would prohibit pre-dispute agreements requiring arbitration of a "sex discrimination dispute." Although the proposed bill is still working its way through Congress and may not ultimately become law, some large employers have announced they will no longer require arbitration of harassment complaints.

Several states have also passed or proposed laws banning or limiting pre-dispute agreements requiring arbitration of sexual harassment claims. It is unclear how those laws will fare in light of the US Supreme Court's May 2018 decision in *Epic Systems Corp. v. Lewis*, which upheld the enforceability of agreements requiring employees to arbitrate their claims, and waive the right to a class action, under the Federal Arbitration Act.

Employer Losses and Liability for Harassment Claims

Sexual harassment claims can result in significant compensatory and punitive damages, as well as attorneys' fees. If an employee sues a supervisor for alleged harassment, the employer will be vicariously liable if the harassment culminates in adverse employment action. In other circumstances, the employer might be able to establish a defense that it exercised reasonable care and the plaintiff acted unreasonably by failing to report. An employer can be liable for harassment by a plaintiff's co-workers if the employer knew, or should have known, about the harassment and failed to take remedial action. Employers are typically required by state law and/or contracts to indemnify and defend individuals accused of harassment, provided that the individual was acting within the scope of employment.





Shareholder and Investor Suits and Investigations

Allegations of sexual misconduct by high ranking corporate employees can also prompt costly internal investigations and regulatory scrutiny, and expose businesses and directors and officers to liability.

Securities Fraud Class Actions

Securities fraud class actions often follow public revelations of previously undisclosed sexual harassment claims, especially if such a revelation leads to a significant stock price drop. Many such lawsuits have been filed by investors, both before and after #MeToo.

Although plaintiffs must meet high pleading standards in these types of cases, the potential liability exposure is enormous, measured by the dollar loss for each affected share of stock. Legal costs to defend these suits are commensurately high, particularly if individual defendants demand funding for separate legal counsel.

Shareholder Derivative Suits

Claims against high-profile corporate actors can also attract shareholder derivative suits carrying significant exposure. This was dramatically illustrated by a recent well-publicized action filed in the Delaware Court of Chancery, *City of Monroe Employees' Retirement System v. Murdoch et al*, which settled for $90 million on the same day plaintiffs filed their shareholder derivative complaint with the court. The plaintiffs were able to build their case through pre-suit "books and records" discovery, which is permitted under most state corporate laws.

Derivative claims are, by design, difficult for shareholder plaintiffs to plead and maintain. Shareholders seek to stand in the shoes of the company and assert claims against alleged bad actors and bystanders who have allegedly looked the other way or enabled their conduct. Derivative suits invariably charge boards of directors with alleged failure to implement and monitor systems sufficient to detect or prevent misconduct, resulting in loss and damage to companies.

To establish that directors are liable, a plaintiff must allege with factual particularity and then prove that a board utterly failed to implement any reporting or information systems or controls — or having implemented these, consciously failed to monitor or oversee their operations, thus disabling the board from being informed of risks or problems requiring its attention.

Although derivative suits are typically settled or dismissed before judgments, the prospect of a judgment is serious for individual directors and officers. In order to achieve a monetary recovery for the company, plaintiffs must prove non-exculpable bad faith or breach of the duty of loyalty, which is outside the indemnifiable standard of conduct under most states' corporate law.

Investigations

Faced with damaging revelations of sexual misconduct by top executives, it is incumbent upon boards of directors to investigate allegations and take corrective action. This obligation is explicit when a shareholder makes a pre-suit demand for corporate action on which the board must exercise informed good faith business judgment.

An internal investigation will focus on alleged wrongdoers and others who may have enabled the conduct or looked the other way, violating corporate policy. Feeling the heat — including possible disclosure of their conduct and statements to the SEC or other government enforcement agencies — witnesses often ask businesses to advance funds for personal counsel to represent them, thus adding more lawyers to a company's roster of legal representation.

Indemnification and Advancement

Directors and officers have several layers of protection for out-of-pocket expenses and losses in defending against alleged violations of securities laws or breach of fiduciary duty claims.

State laws generally permit or require companies to indemnify directors, officers, and employees who must incur costs to defend themselves in lawsuits or proceedings involving their jobs. Some conduct, however, is not indemnifiable. Delaware, for example, permits indemnification for defense costs, judgments, fines, and settlements incurred by directors, officers, and employees who acted "in good faith and in a manner reasonably believed to be in, or not opposed to, the best interests of the corporation." A corporation is not legally permitted to indemnify an individual for expenses resulting from conduct that fails to meet these "minimum standards of conduct." A corporation also cannot indemnify an individual for a judgment of monetary liability to the corporation itself, which is the remedy typically sought in a shareholder derivative suit.

On the other hand, corporate laws generally permit companies to advance legal expenses before any final determination of whether an individual meets minimum standards of conduct for indemnification. Corporate executives often strengthen their rights to indemnity and advancement by contract, which can make it difficult for a company to refuse advancement to bad actors whose conduct has not been adjudicated by a court.

Many states, including Delaware, also permit companies to limit the personal liability of directors (but not officers) to the corporation and its stockholders with an "exculpation" provision in the articles of incorporation. Although these provisions can excuse directors from breach of fiduciary duty of care claims, corporate laws do not permit exculpation for breach of the fiduciary duty of loyalty, bad faith, intentional misconduct, or knowing violations of law — the same claims that are typically asserted in shareholder derivative litigation.

Insurance Considerations

Employment Practices Liability

The #MeToo movement has highlighted the significant liability that directors and officers can face beyond "traditional" directors and officers (D&O) liability claims, particularly with respect to employment risks. Employment practices liability (EPL) insurance provides coverage for claims brought by current and former employees and job applicants against the company and its directors, officers, and employees, relating to wrongful acts allegedly committed in the course of the claimant's employment. Some D&O policies, such as those for small companies or nonprofit entities, are designed to contain EPL insurance coverage. However, rather than allow an EPL claim to erode D&O limits, many companies elect to purchase standalone EPL policies.

EPL insurance is designed to respond to claims alleging sexual harassment, discrimination, retaliation, and other employment-related wrongful acts defined under the policy. Third-party liability coverage is also an option under most EPL policies; this provides coverage for claims of discrimination and harassment asserted by *non-employee* third parties, including customers and vendors.

Since EPL coverage was first developed in the 1990s, sexual harassment has been one of the core perils that it's been designed to address. As such, coverage for these claims is not necessarily in question. But the rash of #MeToo claims over the last year has served to test the boundaries of EPL policies, particularly in the context of sexual harassment claims coupled with allegations of sexual assault. Nearly all EPL policies contain a bodily injury exclusion, which could be invoked if there are allegations of physical contact. The sexual harassment component of the claim should not be subject to the exclusion, particularly if it is cast as a "for" exclusion, rather than the much broader "based upon, arising out of" wording that may apply to other EPL policy exclusions.

In certain industries and jurisdictions, insurers are considering reduced capacity, increased pricing, and even higher retentions for workplace harassment claims. Over the last year, EPL insurers have been asking many more questions regarding training and reporting, and some insurers have indicated a desire to hold more in-person underwriting meetings. At a minimum, insurers expect employers to reassess and update their anti-harassment and anti-retaliation policies. Merely "checking the box" is no longer enough.

Employers across all industries should consider a number of steps to both mitigate potential exposure and address insurers' concerns. These include:

- Conducting in-person, interactive training of employees.
- Establishing proportional discipline for offensive conduct.
- Maintaining records of anti-harassment and anti-retaliation policy publication and training.
- Offering employees multiple channels through which they can anonymously report misconduct.

These and other measures can help stave off future liability that can affect corporate brands and bottom lines, and serve to present employers as better risks to EPL insurers.

Directors and Officers Liability

The prospect of personal liability in the wake of allegations of sexual harassment or failure to monitor workplace conduct, coupled with unassured corporate indemnification and advancement, makes D&O liability insurance an important risk transfer tool that can, at times, become the last line of defense for an individual director or officer.

D&O coverage arising out of the #MeToo movement comes in many forms. For example, some, but not all, public company D&O policies include limited EPL coverage for directors and officers. It is imperative that directors and officers are aware of whether their companies' D&O policies include EPL coverage. If such coverage is present, it's vital that directors and officers understand their reporting obligations.

Beyond EPL coverage that may be part of a D&O policy, traditional D&O coverage could be triggered. Accordingly, you should understand the breadth of coverage under your D&O policy. Among other questions, you should ask:

- What triggers coverage under our D&O policy and what are your reporting obligations?
- Are there exclusions in our policy that might apply to a D&O claim arising out of a #MeToo-related matter? Can those exclusions be narrowed?
- How broad is the investigations coverage in our D&O policy?
- Do we have sufficient policy limits, including sufficient Side-A coverage (coverage only for directors and officers for non-indemnifiable loss)?

Although the impact of the #MeToo movement is not limited to potential D&O coverage considerations, D&O insurers are now looking at ways to assess the "tone at the top" of an organization. Risk professionals should therefore expect the underwriting process for their D&O program to change going forward. Insurance buyers should be prepared to answer questions about their employment policies during D&O underwriting meetings, including, but not limited to, how often they update their anti-harassment and anti-retaliation policies, whether those policies are supported by senior leaders, and what guidance and channels are available for reporting workplace misconduct.

In the wake of the #MeToo movement, businesses and individuals who committed, enabled, or failed to prevent misconduct are being held accountable through litigation and regulatory action. The costs of such actions can be high, but businesses can be proactive in reducing the number, frequency, and severity of the claims they face and building effective insurance coverage that can respond as intended in the event of a loss.

For more information, visit marsh.com, contact your Marsh representative, or contact:

KELLY THOERIG
Employment Practices Liability Coverage Leader
Marsh FINPRO
+1 804 344 8975
kelly.thoerig@marsh.com

SARAH D. DOWNEY
Directors and Officers Liability Product Leader
Marsh FINPRO
+1 212 345 3122
sarah.d.downey@marsh.com

PAMELA S. PALMER
Co-chair Securities Litigation Practice
Pepper Hamilton LLP
+1 213 928 9814
palmerp@pepperlaw.com

SUSAN K. LESSACK
Partner
Employment Counseling and Litigation
Pepper Hamilton LLP
+1 215 981 4569
lessacks@pepperlaw.com

How can Directors and Officers Mitigate the Risk of Claims and Losses?

- Ensure that the board of directors receives reports about complaints and how they are handled, enabling meaningful insight into corporate culture and practices.
- Seek a good "tone at the top" through executive sponsorship of and participation in training and anti-harassment initiatives.
- Ensure that the company's insurance coverage is adequate to protect the company from excessive loss and to protect the directors and officers from personal liability.