2015 CLM Annual Conference

Palm Desert

Managers Liability

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I. Introduction: What Are Management Liability Policies?

Management Liability Insurance is a combination of Directors & Officers liability, Employment Practices liability and Fiduciary Liability insurance. The policies protect against the most common claims against companies such as, allegations of wrongful termination, discrimination and sexual harassment. They also provide insurance for charges of mishandling investment funds or failing to carry out investment instructions. They also provide protection from shareholder suits alleging a lack of proper "corporate governance."

Sexual harassment claims may get the most press, but there are many examples of when management liability insurance is invoked that are in the news every day. Under the business judgment rule, the directors and officers are granted broad discretion in their business activities. However, shareholders and third parties scrutinize the decisions made by the directors and officers and suits are common.

Corporate law is typically at the state level with most corporations often domiciled in Delaware. Publicly traded companies are subject to more federal claims, particularly due to the Securities Act of 1933 and the Securities Exchange Act of 1934.

Other managers may be covered under professional liability policies and work as property managers, fiduciaries or business managers. Those managers will typically be covered by Errors and Omissions insurance.

II. How Does Liability Arise?

Liability can exist for directors and officers when they cause financial harm to the corporation, act solely on their own behalf and to the detriment of the corporation, or commit a crime or wrongful act. Certain acts may subject an officer or director to personal liability and other acts, although they would otherwise subject them to liability, may be either indemnified by or insured against by the corporation.

Directors and officers may be personally liable for financial harm caused to the corporation if they: Breach their duty of care to the corporation, breach their duty of

loyalty to the corporation, misappropriate a corporate asset for personal use or use by another business, commingle personal and business assets or fail to disclose potential or actual conflicts of interest.

The types of claims are dependent upon the nature of the corporation. For public companies, claims are primarily due to lawsuits by shareholders after financial difficulties (69% of publicly traded companies had claims of shareholder lawsuit in the past 10 years as opposed to 21% of private companies). Other claims arise from shareholder-derivative actions, creditors (particularly after insolvency), customers, regulators (bringing civil or criminal charges), and competitors (for anti-trust or unfair trade practice allegations). For non-profit companies, claims are typically related to employment practice and less commonly regulatory or other fiduciary claims. For private companies, claims are often from competitors or customers for antitrust or deceptive business practices. D&O type lawsuits cost an average of $300,000.

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For business managers, property managers, healthcare administrators or other professionals who manage accounts or funds, the claims may appear to be similar to claims against directors and officers. They involve breach of fiduciary duty, typically after a loss of funds or an investment, but they can also involve misappropriation, misrepresentation, and even unfair competition or conversion.

III. Where Does Indemnity Come In?

Indemnification of directors and officers means that the corporation will reimburse them for expenses incurred and amounts paid in defending claims brought against them for actions taken on behalf of the corporation. A company’s articles of association often includes an indemnification provision holding the officers harmless for losses occurring due to their role in the company. The purchased insurance is typically in addition to this corporate indemnification, or reimburses the corporation. In some states corporations may be mandated to indemnify directors and officers in order to encourage people to take the positions and in most cases the corporations have the option to indemnify their officers. However, in certain cases the corporation may be explicitly forbidden from indemnifying such director or officer. Liabilities which are not indemnified by the corporation are potentially covered by certain types of D&O insurance. States have recognized that without some method to limit the liability of directors and officers for claims brought against them, it would be difficult for corporations to find anyone willing to serve as officers or directors. As a result, most States’ corporation statutes now contain provisions regarding indemnification and insurance for officers and directors.

With respect to professional managers, indemnity may also be an issue. A property manager may agree to indemnify an owner for any losses resulting from the manager's mistakes or if the parties used a management company form then it may be the manager who is entitled to indemnity from the owner. Indemnity can become an issue with respect to insurance coverage, if there are policy exclusions for contractual claims. Also, there can be no additional insured on an errors & omissions policy. In HOA cases, the directors and officers are indemnified by the HOA and they are immune for any negligent actions,

absent fraud or intentional conduct.

IV. Types of Claims Made Against Managers

In 2010, 31% of companies reported one or more D&O claims over the last 10 years, up from 17% in 2008. 35% of nonprofit organization reported experiencing a claim, 29% of public companies and 26% of private organizations also reported experiencing a claim. The most frequent type of claim against public companies involved direct claims from shareholders/investors (66%). Employment practices were the most frequent type of claim against nonprofit organizations (67%) and private organizations (45%).

The susceptibility of directors and officers to claims depend on the size of the company, the company's type of business, whether the company is publicly or privately owned, and the number of shareholders.

With respect to professional liability claims, the claims are usually more specific to a specific client such as, a property manager failing to raise rent when a lease has a provision that allows raising the rent on year 3 only, or a fund manager making bad investments with the client's funds.

The following are the types of claims that arise under management liability with examples:

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• Unfair competition/Theft of Trade Secrets: An officer leaving his/her former company and starting a new company or work that is in direct competition to the former company. While unfair competition claims are also made against property and fund managers, typically trade secrets are not involved.

• Misappropriation of Trade Secrets: Employees can be alleged to have used trade secrets and/or shared proprietary information with a new company while working for the former company. Property managers, fund managers and other fiduciaries are often sued for misappropriation. They claim to steal money, clients, or inflate the value of their services.

• Breach of Fiduciary Duty: Selling assets to a company and breaching a contract to sell the assets to another company is a directors and officers example. Property/asset managers and fiduciaries are always sued for breach of fiduciary duty since any mistake they make can be deemed as a breach of such duty. Breach of the fiduciary duties of prudence and/or loyalty against fiduciaries of ESOPs or 401(k) plans have been popular since the subprime mortgage market crisis, as many employees lost their retirement savings, or some portion thereof, as a result of their investments in their company stock whose value may have plummeted due to difficulties in the stock market during this period. There are however, exceptions. Even with attorneys acting negligently toward their clients-- for there to be a fiduciary duty breach --the claim has to be fiduciary in nature (for example, breaching confidentiality).

• Shareholder Dispute: Alleged misrepresentations or omissions in connection with purchase and sale of company, stocks or assets, or class actions relating to stockholders'

loss of investment in stocks they purchased.

• Employment Practices Liability: this would cover wrongful termination, derogatory comments when age or sex are at issue, sexual harassment involving managers' inappropriate behavior, harassment and bullying by managers, or unfair dismissal. Discrimination/harassment type disputes can arise in the context of managers. For example, a property manager who discriminates in leasing may cause a personal exposure to the broker of record as well. Meyer v. Holley 537 U.S. 280 (2003).

• Occupational Health & Safety issues: Investigation and prosecution after an employee is injured. This does not typically involve business or fund managers although they may owe indemnity to owners for personal injuries.

• Environmental Enforcement Actions: Environmental enforcement actions can result in findings of liability against the individual directors and officers of companies that caused environmental damage or harm. Prosecution can involve companies who work with tankers, fuel, carbon emissions from factories and so forth. Since property and fund managers do not own the properties they manager these claims do not typically involve them, although conceivably, a property manager mishandling an environmental issue can be liable to the owner.

• Trustee Liability: Misappropriation of money earmarked for employees' salaries, or pensions, or misappropriating monies or property that belong to the client. V. Management Liability Policy

In the 1960s, D&O insurance was sold primarily based on the concerns of directors & officers of personal financial protection, but the coverages have evolved to include corporate entity coverage.

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Fidelity bonds typically afforded specified first-party coverage for losses corporations incur due to certain acts of their officers, directors, or employees. D&O coverage, on the other hand, was not intended to be corporate insurance, much less an attempt at general corporate insurance for liability caused the corporation by virtue of the acts of its directors and officers.

D&O insurance today is often coupled with coverages designed to protect the corporation, in addition to its directors and officers, from various liabilities. Traditional D&O policy applied to public companies with three insuring clauses. These insuring clauses are still used today and are termed:

Side-A or "non-indemnified" loss coverage is coverage to individual directors and officers when not indemnified by the corporation as a result of state law or financial capability of the corporation; however, exclusions may apply if a corporation simply refuses to pay the legal defense/loss of a director or officer, or if a bankruptcy court issues an order preventing such indemnification. A corporation may not indemnify its directors or officers because it either (1) is prohibited by law from doing so, (2) is permitted to do so by law and the company's bylaws but chooses not to do so, or (3) is

financially incapable of doing so, due to bankruptcy, liquidation, or lack of funds. Many policies include a provision to the effect that the company will be presumed to provide indemnification to insured persons to the fullest extent permitted by law. The laws regarding indemnification differ from jurisdiction to jurisdiction. A-Side only coverage is most commonly implicated in high exposure claims against directors and officers of bankrupt entities. There are some large companies (more than $10 billion in assets) that are only purchasing A-Side coverage (and no Side B or C coverage).

Side-B or "indemnified" loss coverage provides coverage for the corporation (organizations) when it indemnifies the directors and officers (corporate reimbursement).

Side-C or "entity securities coverage" provides coverage to the corporation (organizations) itself for securities claims brought against it. Entity coverage provides protection for the corporation for its own liability. The entity coverage in public company D&O policies usually is limited to securities claims, which is a defined term in most policies. Securities claim is typically defined to mean a claim made in connection with the purchase or sale or offer to purchase or sell a company's securities and/or a claim for any actual or alleged violation of the Securities Act of 1933, the Securities Exchange Act of 1934 or any similar federal or state statute. In private company D&O policies, coverage may be provided for claims for wrongful acts against the company. This means that entity coverage under a private company D&O policy may be significantly broader than entity coverage under public company D&O insurance policies. Many policies today provide such coverage to the corporation whether or not its directors and officers are also sued; other policies, however, provide such coverage only where the corporation is a co-defendant with its directors and officers. Entity coverage may be part of the policy form as "Insuring Agreement C" or may be added as an endorsement

D&O policies may also provide an additional Side-D clause, which provides for a sublimit for investigative costs coverage related to a shareholder derivative demand. More extensive coverage can be obtained for individual directors and officers under a Broad Form Side-A DIC ("Difference in Conditions") policy for example, in the face of U.S. bankruptcy courts deeming the D&O policy part of the bankruptcy estate and otherwise more fully protect the personal assets of individual directors and officers.

Other coverages may include, Employment Practices Liability ("EPL"), often by endorsement to the D&O policy or as a stand-alone policy issued to the company. This coverage typically protects directors, officers, employees and/or the company against employment-related claims brought by employees and, in certain circumstances, specified third-parties. For example, it provides coverage for wrongful dismissals or failures to promote, sexual harassment, and other violations of federal, state or local employment and discrimination laws brought by the company's employees.

Fiduciary liability insurance, like EPL coverage, is usually purchased as a stand-alone policy or endorsed to an organization's D&O policy. Fiduciary coverage generally protects fiduciaries against claims under the Employee Retirement Income Security Act of 1974 ("ERISA"), such as for breaches of the duties of loyalty or prudence or for failures to make proper disclosures . In 2008, there was a large jump in the number of

those policies sold.

In addition to public or private companies, and non-profit organizations (including Homeowners Associations), D&O coverage can be tailored toward a specific industry. For example, types of healthcare organizations eligible for D&O coverage include: Hospital/health systems, clinics/physician groups, ambulatory surgery centers, hospice/home health care centers, blood/organ collection centers, assisted living facility, behavioral and mental health centers, laboratory facilities, rehabilitation/dependency facilities, skilled nursing facility/retirement homes. If those companies would require professional liability insurance, that would fall under a separate policy.

Finally, errors & omission insurance (E&O) covers professionals who get sued. The coverage applies to the agent (the licensee) and to the company. Managers are most often independent contractors but whether they are independent contractors or employees, the brokers and the companies are vicariously liable for the agent's conduct when the agent is acting within the course and scope of the agency. E.g., California Business & Professions Code § 10032(a).

VI. Typical Exclusions

The "severability clause:" This may be intended to protect against a failure to disclose material information or for the willfully provides inaccurate information. However, in certain jurisdictions it may be ineffective.

Conduct Exclusions: Most policies contain one or more exclusions precluding coverage for certain types of conduct. The conduct exclusions typically preclude coverage for loss relating to fraudulent or criminal misconduct and for loss relating to illegal profits or remuneration to which the insured is not legally entitled. These exclusions typically are followed by a severability clause – that is, a caveat providing that the acts or knowledge of one insured will not be imputed to any other insured for the purpose of applying the exclusion. The most important wording variant addresses what is required in order for the exclusion to be triggered. In recent years, these provisions usually require a final "adjudication" that the precluded conduct has actually occurred in order for the exclusion to be triggered.

Intentional illegal acts or illegal profits are not covered under insurance policies; coverage would only extend to "wrongful acts" as defined under the policy, which may include certain acts, omissions, misstatements while acting for the organization. Due to exclusions and as a matter of public policy, coverage is not provided for criminal fraud.

Insured v. Insured Exclusion: This exclusion bars coverage for claims made by an insured (e.g., a director, officer or corporate insured) against another insured. In addition, the exclusion may bar coverage for claims brought by anyone directly or indirectly on behalf of or at the behest of an insured. Where a lawsuit is brought by or with the "active assistance" of an insured, the exclusion bars coverage. See e.g. Voluntary Hospitals of America, Inc. v. National Union Fire Ins. Co., 859 F. Supp. 260 (N.D. Tex.1993). The

exclusion may be modified with "carvebacks" for certain categories of claims, such as, derivative and employment practices claims or claims by a bankruptcy trustee. The exclusion essentially prevents a company from suing or orchestrating a suit against its directors and officers in order to collect insurance proceeds. Questions regarding the application of the exclusion arise in the context of derivative lawsuits, bankruptcies and receiverships. A significant amount of litigation involving the IvI exclusion relates to claims against companies in bankruptcy or receivership. The question is then whether a trustee or debtor in possession stands in the shoes of the corporation. See e.g., Biltmore Associates LLC v. Twin City Fire Insurance Company, et al. , (9th Cir. 2009); Reliance Ins. Co. v. Weiss, 148 B.R. 575 (E.D. Mo. 1992); Mount Hawley Ins. Co. v. FSLIC, 695 F. Supp. 469 (C.D. Cal. 1987); Gary v. Am. Cas. Co. of Reading, 753 F. Supp. 1547, 1555 (W.D. Okla. 1990); FDIC v. American Casualty Co., 814 F. Supp. 1021 (D. Wyo. 1991).

Regulatory Exclusion: Some policies also include a regulatory exclusion, which precludes coverage for claims brought by any governmental, quasi-governmental, or self-regulatory agency. The regulatory exclusion was at the forefront of D&O litigation in the late 1980s and early 1990s in connection with failed financial institution claims brought by the FDIC, FSLIC and RTC arising out of the S&L crisis.

Prior and Pending Litigation Exclusion: Prior and pending litigation exclusions generally exclude coverage for (1) claims pending prior to the inception of the policy, or another agreed upon date, and (2) subsequent claims based on the same or related facts or circumstances. Conflicts primarily arise regarding the second component of this exclusion. Specifically, the question arises as to when a subsequent claim is based on sufficiently overlapping facts and circumstances to fall within the scope of the exclusion. Courts have held that the two claims need not be brought by the same plaintiffs to trigger the exclusion. See e.g., Zunenshine v. Executive Risk Indem. Co., No. 97 Civ. 5525, 1998 U.S. Dist. LEXIS 12699, at *5 (S.D.N.Y. Aug. 17, 1998) aff'd, 182 F.3d 902 (2d Cir. 1999); Acosta, Inc., et al. v. Nat'l Union Fire Ins. Co., et al., 39 So. 3d 565 (Fla. Dist. Ct. App. 2010); Ameriwood Indus. Int'l Corp. v. Am. Cas. Co. of Reading, Pennsylvania, 840 F. Supp. 1143 (W.D. Mich. 1993).

Professional Liability Exclusion: D&O policies do not provide coverage for liability associated with the provision of professional services. Thus, where a bank officer is liable for acts as a banker rather than an officer of the bank, a D&O policy with a professional liability exclusion would not provide coverage. Similarly, where a doctor is the president of a professional corporation, the D&O policy would only protect him or her against liability from acts as president of the corporation, and would not provide coverage for professional malpractice claims. The line between professional services and acts outside the scope of this exclusion can be a fine one. Courts draw a distinction between those acts that require special training or are at the heart of the profession and those acts that are administrative in nature. See e.g. Harad v. Aetna Cas. and Sur. Co., 839 F.2d 979 (3d Cir. 1988).

Prior Acts Exclusion: A prior acts exclusion bars coverage for claims arising out of an insured's wrongful acts prior to a specified date. The date may coincide with the

termination of coverage under a previous policy. The date may also coincide with a change in corporate status – such as a merger or acquisition.

Rescission/Known Loss: An insurer may seek to rescind a policy if it determines that the company made material misstatements in the application for insurance or the company's public filings that were relied upon by the insurer in issuing the policy. For instance, if a company overstates its earnings or financial status in the application process and the insurer relies on these statements in issuing a policy, the insurer may have a claim for rescission of the policy based on a material misrepresentation. Similarly, an insurer may present evidence of "known loss," claiming that the company knew at the time it was purchasing the insurance that a claim had been or was likely to be made. Many of the accounting scandals of the late 1990s—such as Enron, Adelphia, and WorldCom—raised these issues.

Allocation: D&O policies usually include detailed allocation clauses that require the parties to negotiate an allocation agreement (between company and directors and officers). If the parties are unable to agree, the insurer may be required to advance the percentage of loss not in dispute and submit to arbitration on the allocation amount in dispute.

Bankruptcy Claims: A corporation's bankruptcy may have a significant impact on its directors and officers' insurance coverage. Courts are mixed on the question of whether the proceeds of the D&O Policy are the property of the debtor's estate. See In re Louisiana World Exposition, Inc. , 832 F.2d 1391, 1400-01 (5th Cir. 1987); In re Global Crossing Securities and ERISA Litig, 225 F.R.D. 436, 463 (S.D.N.Y. 2004); In re Adelphia Communications Corp., 298 B.R. 49, 52-54 (S.D.N.Y. 2003); In re CyberMedica, Inc., 280 B.R. 12 (Bankr. D. Mass. 2002).

Coverage may specifically state that it is limited to those claims connected to an insured's capacity as an insured director or officer of the company or while working on a transaction or a specific insured matter for the company. This issue of capacity recurs throughout any coverage analysis. The limiting language may appear in the insuring clause, in the definitions of "wrongful act" or "insured" found elsewhere in the policy, or in all three clauses. Although a claim sometimes implicates an insured in a single and clear capacity, a claim may well arise out of an individual's multiple capacities. For example, an individual may be sued as a director and a shareholder of a company, or an officer of a homeowner's association may also be a homeowner and it may not be clear whether his or her actions were taken as one or the other – or both. Similarly, a corporation's lawyer may also sit on the board of directors or be a corporate officer. Also, a property manager may also be sued as an owner if he/she owns shares in the building, he may be sued for misrepresentation in the sale of a property as a co-owner or he may be engaged in many projects unrelated to the business of managing clients' funds.

VII. Defense Issues

Most public company D&O policies do not impose a duty to defend on the insurer. They do, however, provide coverage for defense costs and give the insurer the right to associate

with the defense and approve defense strategies, expenditures, and settlements. Private company D&O insurance is also often written on a duty to reimburse basis. In addition, however, private company D&O insurance is also sometimes written on a duty to defend basis, under which the insurer selects defense counsel and controls the defense.

A D&O insurer under a duty to reimburse policy cannot impose its choice of counsel on an insured – the insured generally has the right to select counsel, subject to the insurer's consent. D&O policies typically provide that an insurer may not unreasonably withhold approval of an insured's choice of counsel. Also, D&O policies insurers are only required to reimburse reasonable defense costs arising out of covered claims.

E&O policies can be more strict. They provide both a duty to defend and they can have the carrier dictate who is the defense firm that would handle the case. In recent years some carriers have become more open to allowing the insureds their own choice of counsel.

Management policies generally define claim as any (1) civil, criminal or administrative proceeding, or (2) written demand for damages against an insured. Who is included as an insured will depend on which coverages are implicated and how the term is defined in the policy. That is, if it is a securities claim, and the policy so provides, a claim may be made against the company or against a director or officer. If it is an employment claim, and the policy so provides, a claim may be made against the company, a director or officer, or an employee. If it is an ERISA claim, and the policy so provides, a claim may be made against the plan, the sponsor organization or the plan's fiduciaries. If it is a claim against a property or asset manager, the policy may not cover the perpetrator manager who stole money from the client, but it may cover the company, especially if there is an innocent insured clause.

Many policies now include a more detailed definition of "claim," which includes civil proceedings, criminal proceedings and administrative proceedings commenced by specific actions, such as service of a complaint, indictment, or formal charge. Some policies also expand the definition to include formal investigations. Whether a subpoena issued to an insured person by a regulatory body constitutes a claim is a common issue, which often depends both on the specific facts and circumstances surrounding the subpoena and the specific language of the applicable policy.

D&O policies often contain an "interrelated wrongful acts" clause that treats as a single "wrongful act" all claims that arise out of the same common set of facts. This is an issue that often arises in connection with large towers of insurance that span multiple years. For example, an investigation by a governmental agency and a separate private lawsuit that are both based on a common allegation of wrong doing may be treated as an "interrelated wrongful act" for purposes of D&O coverage, even if the public and private underlying claims are made in separate policy periods. The latter made claim will be intertwined with the earlier made claim and will be deemed made when the earlier "related claim" was made. See Seneca Ins. Co. v. Kemper Ins. Co. , 02 Civ. 10088, 2004 U.S. Dist. LEXIS 9159 (S.D.N.Y. May 21, 2004); In re SRC Holding Corp. , 545 F.3d

661 (8th Cir. 2008).

Loss generally includes damages, judgments, awards, settlements and defense costs. Loss usually excludes fines or penalties, taxes, treble (or other multiplied) damages, and matters uninsurable under law. Where treble or multiplied damages are assessed, a D&O policy generally will cover the base amount, but not the multiplied portion of the loss. E&O policies typically will not cover any punitive damages, penalties, or attorney's fees. D&O policies however, may define loss to include punitive and exemplary damages, where insurable by applicable law. It is common for policies to include a provision to the effect that coverage for punitive damages is available to the broadest extent permitted by law. Although the law is still developing in this area, punitive damages are insurable in the majority of states. See, e.g., Omni Ins. Co. v. Jennifer B. Foreman , 802 So. 2d 195 (Ala. 2001); State Farm Mut. Auto. Ins.

Co. v. Stacey Lawrence Sr. and Tobitha Lawrence , 26 P.3d 1074 (Alaska 2001); Byron C. Bailer v. Erie Ins. Exch., 344 Md. 515 (Md. 1997); Shelter Mut. Ins. Co. v. George Dale , 914 So. 2d 698 (Miss. 2005); South Carolina State Budget & Control Board v. Atlee Prince, et al., 403 S.E.2d 643 (S.C. 1991); American Protection Ins. Co. v. Kenneth McMahan, et al., 562 A.2d 462 (Vt. 1989). Those states prohibiting coverage of punitive damages generally base the prohibition on public policy concerns. City Products Corp. v. Globe Indem. Co., 151 Cal. Rptr. 494 (Cal. Ct. App. 1979). There are also some states who codified this. See, Nevada Rev. Statute §681A.095; Utah Code Ann. §31A-20-101 (making punitive damages uninsurable); Haw. Rev. Stat. § 431:10-240 (2010); Montana Code § 33-15-317 (2010).

Restitution or disgorgement of ill-gotten gains by an insured is not insurable loss under an insurance policy even if the policy does not contain an express exclusion for such loss. The rationale for that conclusion is premised on the notion that if the restitutionary damages were paid by the insurer, the insured would be allowed to retain the ill-gotten gain. Level 3 Communications, Inc. v. Federal Ins. Co., 272 F.3d 908 (7th Cir. 2001); Trans Texas Gas Corp. v. U.S. Bank Nat'l Ass'n, 597 F.3d 298 (5th Cir. 2010). In E&O policies payment of a commissions or other compensation type funds (whether owed to the insured or that the insured must disgorge) are also not covered.

VIII. Current Issues

Most recent issues that affect management liability are the Wall Street Reform and Consumer Protection Act, immigration and its effect on EPL claims (in one case, forfeiture amount ordered in an immigration enforcement proceeding that resulted in the company's entry of a guilty plea to a criminal charge was not covered under D&O or EPL) and the Affordable Care Act. In the Summer, the US Supreme Court addressed the scope of fiduciaries' duties in the Fifth Third Bancorp et al. v. John Dudenhoeffer case, 573 U.S. ___ (2014). Recession and the government shut down also were also influential on how policies were written and claims were made. Lastly, more recent issues pertaining to cyber liability and statutes protecting individual privacy have become commonplace wrongs to address for professionals involved in management liability.