

# The Unlikely Pressure for Accountability: The Insurance Industry’s Role in Social Change

Angela N. Aneiros\*

Abstract

*The summer of 2020 witnessed a national reckoning: the murder of George Floyd and the resulting unprecedented Black Lives Matter (BLM) protests. As the BLM movement gained unsurpassed traction, corporate America jumped to show support: Nearly 70% of the 500 largest companies made statements in support of racial justice and more than a third provided financial donations to racial justice organizations/causes. Countless companies made public promises regarding their commitment to diversity, equity, inclusion, and justice (DEIJ) within their organizations. However, companies have largely failed to live up to those promises. The result—a frenzy of diversity driven derivative suits against boards and officers for that failure. Although Director and Officer (D&O) insurance has insulated board and officer’s personal assets, the D&O insurance industry has taken notice of the enduring nature of diversity driven derivative suits. Along with social unrest comes the D&O insurer’s unrest; as premiums increase, limits are lowered, and coverage is dropped, the possibility of a new catalyst for accountability arises—the D&O insurance industry.*

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\* Visiting Assistant Professor of Law, Gonzaga University School of Law. The author would like to thank Abbey Stemler, Karen Woody, and Suneal Bedi for their guidance, insightful comments, and discussions. Also, a special thanks to Zachary Hart of Indiana University Maurer School of Law for his exceptional research assistance.

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INTRODUCTION

The Black Lives Matter (BLM) protests of 2020 comprised one of the largest social movements in U.S. history.<sup>1</sup> Since then, a myriad of companies began assuring the public that their culture and behaviors would embrace diversity, equity, inclusion, and justice (DEIJ).<sup>2</sup> However, most of these corporate promises have fallen short.<sup>3</sup> To see this, one need only to look at

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1 See Larry Buchanan, Quoctrung Bui & Jugal K. Patel, *Black Lives Matter May Be the Largest Movement in U.S. History*, N.Y. TIMES (July 3, 2020), <https://www.nytimes.com/interactive/2020/07/03/us/george-floyd-protests-crowd-size.html> [https://perma.cc/555Q-XSGJ].

2. . See Joyce Gannon, *Companies Launch Diversity Efforts After George Floyd’s Killing, but Will They Last?*, PITT. POST-GAZETTE (Oct. 5, 2020), <https://www.post-gazette.com/business/bop/2020/10/05/Companies-diversity-inclusion-George-Floyd-racism-equity-Pittsburgh/stories/202010040005> [https://perma.cc/J4YD-4TKA].

3. See JOSH BERSIN & KATHI ENDERES, ELEVATING EQUITY: THE REAL STORY OF DIVERSITY AND INCLUSION 8 (2021), <https://ss-usa.s3.amazonaws.com/c/308463326/media/27436024f0b84dfd274918375735238/202102%20-%20DEI%20Report.pdf> [https://perma.cc/HE7N-DZRG] (“Roughly 80% of companies [studied] are just going through the motions and not holding themselves accountable.”).

the makeup of the Fortune 500, which, as of 2021, has only five Black CEOs and whose boards contain only 1% Black women.<sup>4</sup> The diversity of a company's board is important, setting the tone for the entire company. But how will boards and officers be held accountable for their promises of diversity initiatives?

This Article posits that an oft-overlooked influence on corporate management is the insurance industry, specifically Directors & Officers (D&O) insurance companies. Scholars like Tom Baker and Sean J. Griffith have previously recognized D&O insurance as a potential function for shaping corporate officers' and directors' conduct.<sup>5</sup> As the financier of shareholder litigation, D&O insurers have a considerable incentive to hold directors and officers accountable for their promises, for when corporate managers fail to live up to those promises, shareholders turn to litigation, and D&O insurers are left footing the bill.<sup>6</sup>

Following corporate America's response to the national reckoning of 2020 sparked by the death of George Floyd, a new trend of shareholder litigation has surfaced in an attempt to hold companies accountable to their DEI promises: diversity driven derivative lawsuits. Through derivative suits, shareholders allege that directors are violating their fiduciary duties when they fail to follow through on DEI promises made in public and proxy statements, especially those related to the diversification of their workforces and boards.<sup>7</sup>

This new trend of derivative suits has shocked the D&O insurance industry. As litigation expenses increase and unpredictably large non-indemnifiable settlements are entered into, insurance underwriters are

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4. David Gura, *You Can Still Count the Number of Black CEOs on One Hand*, NAT'L PUB. RADIO (May 27, 2021), <https://www.npr.org/2021/05/27/1000814249/a-year-after-floyds-death-you-can-still-count-the-number-of-black-ceos-on-one-ha> [<https://perma.cc/XPQ8-RKQY>]; Alisha Haridasani Gupta, *Surprise: Women and Minorities Are Still Underrepresented in Corporate Boardrooms*, N.Y. TIMES (June 18, 2021), <https://www.nytimes.com/2021/06/07/us/women-minorities-underrepresented-corporate-boardrooms.html> [<https://perma.cc/ZGM6-S8Z6>]; see also Phil Wahba, *The Number of Black CEOs in the Fortune 500 Remains Very Low*, FORTUNE (June 1, 2020), <https://fortune.com/2020/06/01/black-ceos-fortune-500-2020-african-american-business-leaders/> [<https://perma.cc/P4SZ-5VD9>] (describing how there were only five Black CEOs on the list in 2020).

5. Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors' & Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 488–90 (2007). However, Baker and Griffith's empirical research led to the conclusion that D&O insurance undermined the deterrent effect of shareholder litigation. See *id.* This article will outline how times are different and thus, D&O insurers currently have a great potential to hold directors and officers accountable.

6. *Id.* at 489.

7. See Francesca Odell et al., *Shareholder Complaints Seek to Hold Directors Liable for Lack of Diversity*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 11, 2020), <https://corpgov.law.harvard.edu/2020/08/11/shareholder-complaints-seek-to-hold-directors-liable-for-lack-of-diversity/> [<https://perma.cc/N6TG-UFYX>].

turning their focus on companies' ability to police director and officer behavior or to pay the price: exceedingly high premiums, lower limits, and dropped coverage.

This Article is the first to analyze this new trend in shareholder litigation and extrapolate its likely impact on insurance contracts and subsequent corporate DEI efforts. The Article also contributes to the burgeoning debate surrounding shareholder activism and social change.

The Article proceeds in three parts. Part I describes how recent social movements have led businesses to make promises of change to promote DEI and have largely failed to live up to those promises. Part II outlines how growing shareholder activism has led to a flurry of derivative suits and provides an explanation of how those lawsuits impact D&O insurance. Part III asserts that recent social movements, specifically the BLM movement, have resulted in D&O insurers having the power to hold boards accountable, thereby placing insurance companies in a unique position to advance social justice.

## I. THE ERA OF SOCIAL MOVEMENTS' TANGIBLE IMPACT IN BUSINESS

Over the past decade, there has been an increase in social activism, causing social movements to sweep over the country and across the globe like wildfire.<sup>8</sup> Increasingly, corporate America is being called on to take a stand and be leaders of change.<sup>9</sup> Corporate America has responded, pledging to take a bigger role in improving society.<sup>10</sup> Then the summer of 2020 became a breaking point: George Floyd was murdered and the BLM movement gained unprecedented traction. Currently, social unrest seems to be at an all-

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8. See Jonathan Pinckney & Emmanuel Davalillo Hidalgo, *2021 Will See More Global Protest: Can It Remain Peaceful?*, U.S. INST. OF PEACE (Jan. 21, 2021), <https://www.usip.org/publications/2021/01/2021-will-see-more-global-protest-can-it-remain-peaceful> [<https://perma.cc/PW7W-36MV>]; see also Claire Harbage & Hannah Bloch, *The 2010s: A Decade of Protests Around the World*, NAT'L PUB. RADIO (Dec. 31, 2019), <https://www.npr.org/sections/pictureshow/2019/12/31/790256816/the-2010s-a-decade-of-protests-around-the-world> [<https://perma.cc/SM42-4VYF>] (discussing 2019 and the decade prior as being the decade of protest around the globe).

9. See Geeta Menon & Tina Kiesler, *When a Brand Stands Up for Racial Justice, Do People Buy It?*, HARV. BUS. REV. (July 31, 2020), <https://hbr.org/2020/07/when-a-brand-stands-up-for-racial-justice-do-people-buy-it> [<https://perma.cc/UA2J-4G7M>] (noting 60% of the U.S. population said that how a brand responds to racial justice protests will influence whether they buy or boycott the brand).

10. See Tracy Jan, Jena McGregor, Renae Merle & Nitasha Tiku, *As Big Corporations Say 'Black Lives Matter,' Their Track Records Raise Skepticism*, WASH. POST (June 13, 2020), <https://www.washingtonpost.com/business/2020/06/13/after-years-marginalizing-black-employees-customers-corporate-america-says-black-lives-matter/> [<https://perma.cc/8GX8-UQP9>].

time high. As corporate America responds, the world is witnessing how badly companies can fail as they neglect to put words into actions.

### A. Purpose Of A Business

The role of corporate America in social movements is often hotly debated. The first question posed in such a debate may be whether a business has any role in social justice. This leads to the long-standing question: what is the purpose of a business? The well-worn notion that a business's sole purpose is to generate profits for shareholders has been the premises of corporate America since Milton Friedman's famous article in *The New York Times*.<sup>11</sup> However, in August 2019 the Business Roundtable<sup>12</sup> released a new Statement on the Purpose of a Corporation.<sup>13</sup> The Statement declared businesses to have a "fundamental commitment to all of [their] stakeholders,"<sup>14</sup> which includes "customers, employees, suppliers, communities and shareholders."<sup>15</sup> The Statement further specifically addressed diversity in the workplace and maintained the "fundamental commitment" to invest in their employees by "foster[ing] diversity and inclusion, dignity and respect."<sup>16</sup> According to Alex Gorsky, Chairman of the Board and Chief Executive Officer of Johnson & Johnson and Chair of the Business Roundtable Corporate Governance Committee, the new statement "affirms the essential role corporations can play in improving our society when CEOs are truly committed to meeting the needs of all stakeholders."<sup>17</sup> However, critics suggest the Business Roundtable and supporting CEOs are simply feeding the public lip service: telling

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11. See generally Milton Friedman, *A Friedman Doctrine: The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> [<https://perma.cc/XX2N-Z32M>] (proposing the limited purpose of businesses and their officers).

12. The Business Roundtable is "an association of chief executive officers of America's leading companies working to promote a thriving U.S. economy and expanded opportunity for all Americans through sound public policy." *About Us*, BUS. ROUNDTABLE, <https://www.businessroundtable.org/about-us> [<https://perma.cc/57V7-DULW>] (last visited Aug. 13, 2021).

13. *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> [<https://perma.cc/9UHW-KRDG>].

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

stakeholders what they want to hear but failing to take any action to back up their statements.<sup>18</sup>

In 2020, the Business Roundtable's Statement was put to the test: as corporations were already being scrutinized for corporate diversity efforts,<sup>19</sup> social unrest rocked the nation following the murder of George Floyd.<sup>20</sup> Suddenly, big brands were making corporate justice statements, donating large sums of money, and asserting promises to reflect the importance of diversity in their organizations.<sup>21</sup> But are corporations standing by the new Statement and using this opportunity for change to "improve society"?

## B. Social Movements In the Age Of Amplified DEIJ Demands

Scholars generally agree in defining a social movement as "a deliberate collective endeavor to promote change in any direction."<sup>22</sup> People and groups create and sustain social movements because they need numbers and organization to assert any influence.<sup>23</sup> Social movements work to convert bystanders into adherents and adherents into constituents.<sup>24</sup> In order to sustain movement cohesion and acquire the public's attention, "[p]ublic performance of the cognitively liberated self and displays of unity" are

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18. See Luigi Zingales, Editorial-Opinion, *Don't Trust CEOs Who Say They Don't Care About Shareholder Value Anymore*, WASH. POST (Aug. 20, 2019), <https://www.washingtonpost.com/opinions/2019/08/20/dont-trust-ceos-who-say-they-dont-care-about-shareholder-value-anymore/> [https://perma.cc/7EYB-2B4S] (arguing the new statement of purpose is a misleading marketing ploy, or worse, a dangerous power grab).

19. See, e.g., Mary Beth Ferrante, *Two Years After #MeToo Started, Report Finds Companies Are Not Taking Enough Action*, FORBES (Nov. 13, 2019), <https://www.forbes.com/sites/marybethferrante/2019/11/13/two-years-after-metoo-started-report-finds-companies-are-not-taking-enough-action/?sh=751143075981> [https://perma.cc/H4WQ-G56N] (discussing how companies failed to make cultural changes following the #MeToo movement).

20. See Derrick Bryson Taylor, *George Floyd Protests: A Timeline*, N.Y. TIMES (Nov. 5, 2021), <https://www.nytimes.com/article/george-floyd-protests-timeline.html> [https://perma.cc/Q48G-U5MD].

21. See *infra* Section I.C for further discussion on this topic.

22. Ariana R. Levinson, *Founding Worker Cooperatives: Social Movement Theory and the Law*, 14 NEV. L.J. 322, 337 (2014) (quoting CHARLES TILLY, FROM MOBILIZATION TO REVOLUTION 39–40 (1978) (internal quotation omitted)).

23. See Virginia Sapiro, *The Power and Fragility of Social Movement Coalitions: The Woman Suffrage Movement to 1870*, 100 B.U. L. REV. 1557, 1560 (2020) (citing LEE ANN BANASZAK, WHY MOVEMENTS SUCCEED OR FAIL: OPPORTUNITY, CULTURE, AND THE STRUGGLE FOR WOMAN SUFFRAGE 133–34 (Ira Katznelson, Martin Shefter & Theda Skocpol eds., 1996)).

24. Barbara Bennett Woodhouse & Sarah Rebecca Katz, *Martyrs, the Media and the Web: Examining a Grassroots Children's Rights Movement Through the Lens of Social Movement Theory*, 5 WHITTIER J. CHILD & FAM. ADVOC. 121, 129 (2005) (citing Bert Klandermans, *The Social Construction of Protest and Multiorganizational Fields*, in FRONTIERS IN SOCIAL MOVEMENT THEORY 77 (Aldon D. Morris & Carol McClurg Mueller eds., 1992)).

common within social movements.<sup>25</sup> These tactics include being “protest-oriented and disruptive of the normal course of politics,” and engaging in interest-group-like behavior—for example, by “lobbying external sources . . . and strategically using the media.”<sup>26</sup> Ultimately, one significant achievement for a social movement is to change public opinion.<sup>27</sup>

With most social movements, public opinion can be slow to change:<sup>28</sup> “whether on gay marriage or civil rights, American public opinion tends to drift toward the side advocating equal treatment.”<sup>29</sup> Then came the BLM movement. BLM has been an exception<sup>30</sup> from its inception in 2013 following George Zimmerman’s acquittal for the killing of Trayvon Martin.<sup>31</sup> Since then, the public opinion of race issues has changed drastically,<sup>32</sup> and following the murder of George Floyd, there was a significant spike in support of the BLM movement.<sup>33</sup> As seen in the below graph, in the two weeks following Floyd’s murder, support for BLM “increased by nearly as much as it had over the previous two years.”<sup>34</sup>

25. Tomiko Brown-Nagin, *Elites, Social Movements, and the Law: The Case of Affirmative Action*, 105 COLUM. L. REV. 1436, 1505 (2005) (citing CHARLES TILLY, *SOCIAL MOVEMENTS 1768–2004* 4 (2004)).

26. *Id.*

27. See Hanna Szekeres, Eric Shuman & Tamar Saguy, *Views of Sexual Assault Following #MeToo: The Role of Gender and Individual Differences*, 166 PERSONALITY & INDIVIDUAL DIFFERENCES, 2020, <https://doi.org/10.1016/j.paid.2020.110203> [<https://perma.cc/8EVH-AJGM>].

28. For example, research of the #MeToo movement revealed little change in public perception on issues of sexual harassment and misconduct. See Hanna Szekeres, Eric Shuman & Tamar Saguy, *Views of Sexual Assault Following #MeToo: The Role of Gender and Individual Differences*, 166 PERSONALITY & INDIVIDUAL DIFFERENCES, Nov. 1, 2020, <https://doi.org/10.1016/j.paid.2020.110203> [<https://perma.cc/8EVH-AJGM>]; see also Meredith Conroy, *Are Americans More Divided on #MeToo Issues?*, FIVETHIRTYEIGHT (Apr. 16, 2019), <https://fivethirtyeight.com/features/are-americans-more-divided-on-metoo-issues/> [<https://perma.cc/P7EA-Y3EY>] (comparing 2016 and 2018 data from the Democracy Fund Voter Study Group).

29. Nate Cohn & Kevin Quealy, *How Public Opinion Has Moved on Black Lives Matter*, N.Y. TIMES (June 10, 2020), <https://www.nytimes.com/interactive/2020/06/10/upshot/black-lives-matter-attitudes.html> [<https://perma.cc/N4LK-YV7U>].

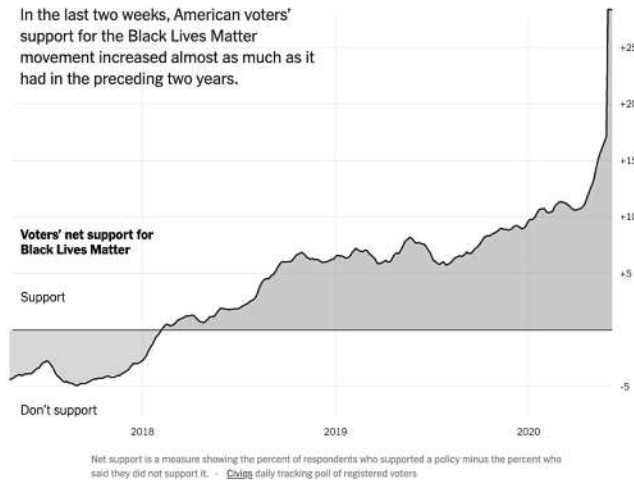
30. See *id.*

31. See Garrett Chase, *The Early History of the Black Lives Matter Movement, and the Implications Thereof*, 18 NEV. L.J. 1091, 1095–98 (2018) (providing a detailed explanation of the early history of the Black Lives Matter movement).

32. See Cohn & Quealy, *supra* note 29.

33. *Do You Support or Oppose the Black Lives Matter Movement*, CIVIQS, [https://civiqs.com/results/black\\_lives\\_matter?uncertainty=true&annotations=true&zoomIn=true](https://civiqs.com/results/black_lives_matter?uncertainty=true&annotations=true&zoomIn=true) [<https://perma.cc/5L63-273Q>] (last visited Aug. 17, 2021).

34. Cohn, *supra* note 29 (citing *Do You Support or Oppose the Black Lives Matter Movement*, CIVIQS, [https://civiqs.com/results/black\\_lives\\_matter?uncertainty=true&annotations=true&zoomIn=true](https://civiqs.com/results/black_lives_matter?uncertainty=true&annotations=true&zoomIn=true) [<https://perma.cc/5L63-273Q>] (last visited Aug. 17, 2021)).



Source: *The New York Times*<sup>35</sup>

This survey, along with several others polled during the weeks following the murder of George Floyd, suggested broad public support for BLM.<sup>36</sup> Simply put, BLM had changed public opinion. With the majority of Americans supporting BLM protests, corporate America followed suit.

### C. How Companies Are Responding To DEIJ Social Movements

Following the rise of the BLM movement in the summer of 2020, companies lined up to show their support. Approximately 66% of the Standard and Poor's 500 (S&P 500) made a statement in support of racial justice.<sup>37</sup> Further, 36% of the companies made financial donations to racial justice organizations or causes.<sup>38</sup> For example, in June 2020, Netflix allocated 2% of its cash holdings, initially up to \$100 million, to financial institutions and organizations directly supporting Black communities.<sup>39</sup>

35. *Id.*

36. See *id.* for a discussion of several surveys and their results regarding public support of BLM.

37. See *S&P 500 Racial Justice and DEI Scorecard Separates Leaders From Laggards*, AS YOU SOW (Mar. 4, 2021), <https://www.asyousow.org/press-releases/2021/3/3/racial-justice-dei-scorecard-leaders-laggards> [<https://perma.cc/3MK9-8UY2>].

38. *See id.*

39. Michael J. de la Merced, *Netflix Moves \$100 Million in Deposits to Bolster Black Banks*, N.Y. TIMES (June 30, 2020), <https://www.nytimes.com/2020/06/30/business/dealbook/netflix-100-million-black-lenders.html#:~:text=The%20streaming%20giant%20will%20permanently,allowing%20them%20to%20lend%20more> [<https://perma.cc/M4E2-4RBQ>]; see also Aaron Mitchell & Shannon Alwyn, *Building economic opportunity for Black communities*, NETFLIX (Aug. 18, 2020), <https://about.netflix.com/en/news/building-economic-opportunity-for-black-communities>



The co-founder and CEO of Netflix, Reed Hastings, personally gave \$120 million to historically Black colleges.<sup>40</sup> Facebook pledged to double the number of Black and Latinx employees by 2023 and increase the number of people of color in leadership positions by 30%, including 30% more Black people in leadership positions.<sup>41</sup> PepsiCo said it would “increase its number of Black managers by 30% by 2025.”<sup>42</sup> Apple committed \$100 million to its racial equity and justice initiative.<sup>43</sup> The list goes on—there are hundreds of examples of responses corporations made in support of BLM.<sup>44</sup> However, for many companies, including Facebook, the public claims these pledges were empty promises or worse, were used to simply raise their profiles.<sup>45</sup>

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[<https://perma.cc/G3DK-2MQK>] (discussing the donations Netflix made to support Black communities).

40. Andrew Ross Sorkin, *Netflix C.E.O. Reed Hastings Gives \$120 Million to Historically Black Colleges*, N.Y. TIMES (June 17, 2020), <https://www.nytimes.com/2020/06/17/business/netflix-reed-hastings-hbcus.html> [<https://perma.cc/KVE8-JQ8F>].

41. Sheryl Sandberg, *Supporting Black and Diverse Communities*, FACEBOOK (June 18, 2020), <https://about.fb.com/news/2020/06/supporting-black-and-diverse-communities/> [<https://perma.cc/7KWY-YT9W>].

42. Gillian Friedman, *Here’s What Companies Are Promising to Do to Fight Racism*, N.Y. TIMES (Aug. 23, 2020), <https://www.nytimes.com/article/companies-racism-george-floyd-protests.html> [<https://perma.cc/MDZ5-65BB>].

43. *See Apple launches major new Racial Equity and Justice Initiative projects to challenge systemic racism, advance racial equity nationwide*, APPLE (Jan. 13, 2021), <https://www.apple.com/newsroom/2021/01/apple-launches-major-new-racial-equity-and-justice-initiative-projects-to-challenge-systemic-racism-advance-racial-equity-nationwide/> [<https://perma.cc/5SWM-XGGX>].

44. For examples of companies’ responses to BLM, see Friedman, *supra* note 42; see also Tiffany Hsu, *Corporate Voices Get Behind ‘Black Lives Matter’ Cause*, N.Y. TIMES (June 10, 2020), <https://www.nytimes.com/2020/05/31/business/media/companies-marketing-black-lives-matter-george-floyd.html> [<https://perma.cc/KP5D-AZK5>] (discussing companies that took a stand on racial injustice and police violence); see also Richard Feloni & Yusuf George, *These Are the Corporate Responses to the George Floyd Protests*, JUST CAP. (June 30, 2020), <https://justcapital.com/news/notable-corporate-responses-to-the-george-floyd-protests/> [<https://perma.cc/FFY7-5YQG>] (discussing corporate responses to the George Floyd protests); Ad Age Staff, *A Regularly Updated Blog Tracking Brands’ Responses to Racial Injustice*, AD AGE (Jan. 13, 2021), <https://adage.com/article/cmo-strategy/regularly-updated-blog-tracking-brands-responses-racial-injustice/2260291> [<https://perma.cc/6FB4-AXGT>] (tracking major brands’ responses to racial injustice).

45. See Jan, McGregor, Merle & Tiku, *supra* note 10; see also Fernando Duarte, *Black Lives Matter: Do Companies Really Support the Cause?*, BBC (June 12, 2020), <https://www.bbc.com/worklife/article/20200612-black-lives-matter-do-companies-really-support-the-cause> [<https://perma.cc/ST35-B3U8>] (discussing how to determine if a company truly supports a cause).

## D. How Companies Have Failed

While corporate America was quick to make statements in support of BLM, their boardrooms are failing to show a commitment to DEIJ initiatives. As of 2020, only four of America's largest corporations have a Black CEO.<sup>46</sup> A retail professional survey found that 64% of respondents said their companies made a public statement in support of the BLM movement; however, a third of those people said their companies have yet to follow up with further action.<sup>47</sup> A survey conducted in May 2021 by Paradigm—a diversity, equity, and inclusion strategy firm—found that two-thirds of Americans say they want their companies to speak out publicly against racial injustice.<sup>48</sup> Moreover, a majority surveyed said they would hold their employers accountable if they failed to do so and an alarming 54% said they would consider quitting if their employer did not take a stand.<sup>49</sup>

This data may give a window into explaining why companies have faced a flood of shareholder proposals aimed at transparency on diversity in the workplace and disclosures regarding campaign contributions targeting positions on social issues.<sup>50</sup> Early 2021 saw a record number of shareholder proposals filed requesting companies to assess whether their DEIJ efforts were effective.<sup>51</sup> While these proposals are assumed to fail,<sup>52</sup> they certainly illuminate the on-going pressure on directors and officers by shareholders to

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46. Duarte, *supra* note 45.

47. Halie Lesavage, *Retail Professionals and Customers Agree: Retailers Should Take Concrete Action Against Systemic Racism*, MORNING BREW (July 20, 2020), <https://www.morningbrew.com/retail/stories/2020/07/20/retail-professionals-customers-agree-retailers-take-concrete-action-systemic-racism?email=julia.gray@thinknum.com> [<https://perma.cc/67TY-7FH7>].

48. Ben White, *Corporate America Got More 'Woke.' Will It Last?*, POLITICO (May 25, 2021), <https://www.politico.com/news/2021/05/25/george-floyd-death-corporate-america-diversity-490016> [<https://perma.cc/L8CQ-62J3>].

49. Jessica Guynn, *One Year After George Floyd's Death, Two-Thirds of Workers Want Their Companies to Speak Out Against Racism*, USA TODAY (May 20, 2021), <https://www.usatoday.com/story/money/2021/05/20/george-floyd-racism-workers-corporate-america-black-lives-matter/5154145001/> [<https://perma.cc/JK3L-C74U>]. Notably, the survey found that the percentage of respondent who affirmed they would hold their employers accountable and would consider quitting was higher among younger workers who are especially engaged in social justice issues. *See id.*

50. *See* White, *supra* note 48; *see also* Lorraine Woellert, Catherine Boudreau & Kellie Mejdritch, *Shareholders Target 'White Man's World' with Record Demands for Diversity Data*, POLITICO (Apr. 6, 2021), <https://www.politico.com/news/2021/04/06/shareholders-diversity-data-479159> [<https://perma.cc/Z9EA-PRZB>] (discussing shareholder proposals to place diversity questions up for a vote).

51. White, *supra* note 48.

52. *Id.*

hold companies accountable.<sup>53</sup> Now the question is, what will force directors and officers to change their ways to match their promises?

## II. MOBILIZING DIRECTORS AND OFFICERS TO CHANGE

In order for social movements to effect change, it is not enough for a company to make promises to change policies and practice: the board and officers need to make that change. Shifting board and officer behavior to match desired policy and practices is not an easy task. Nevertheless, D&O insurance may have a unique ability to hold boards and officers accountable. As shareholder activism has increased, so has shareholder litigation. Most recently, social movements, particularly the BLM movement, have induced a new wave of derivative suits naming directors and officers as the failures of corporate diversity commitments. While some cases are dismissed, others are settling for record high amounts. Interestingly, D&O insurance covers the costs of such litigation, therefore there is little direct incentive for the boards and officers to alter their behavior. As a result, D&O insurers are taking note and may be the new catalyst for director and officer accountability.

### A. Shareholders' Role In Mobilizing Change

Historically, most shareholders did not exercise their right to vote<sup>54</sup> and even when shareholders did vote, they rarely challenged corporate directors.<sup>55</sup> Additionally, shareholders rarely engaged in proxy contests.<sup>56</sup> When they did, they often failed.<sup>57</sup> Similarly, shareholders rarely engaged corporate officers and directors, seldom submitting shareholder proposals.<sup>58</sup> Most shareholders lacked the incentive to gather the information necessary

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53. *See id.*

54. Lisa M. Fairfax, *From Apathy to Activism: The Emergence, Impact, and Future of Shareholder Activism as the New Corporate Governance Norm*, 99 B.U. L. REV. 1301, 1307 (2019) (citing Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 521 (1990)).

55. *Id.* at 1308 (citing Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–27 (1990)).

56. *Id.* at 1307 (citing Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 688–89 (2007)); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 521 (1990).

57. *Id.* (citing Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 526–27 (1990)).

58. *Id.* at 1308 (citing Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 527, 584 (1990)).

to actively participate in corporate decision making.<sup>59</sup> Because the opportunity cost to become informed in corporate affairs is high while the benefits of becoming informed are low, the majority of shareholders are “rationally apathetic.”<sup>60</sup>

While shareholder activism has existed in the United States since at least the 1930s,<sup>61</sup> it gained traction in the late 1970s<sup>62</sup> and rose to prominence in the 1980s as financial tycoons engaged in major “corporate take-over battles.”<sup>63</sup> Subsequently, in the 1990s, shareholder activism became a popular strategy used to influence numerous large corporations.<sup>64</sup> Between 2006 and 2015 “almost one in every six corporations in the Standard and Poor’s 1500 index [was] the target of activist campaigns.”<sup>65</sup> These activist campaigns targeted a variety of American businesses, including Procter & Gamble, Microsoft, Motorola, eBay, and Yahoo.<sup>66</sup>

However, when shareholders wanted to mobilize a business to change their policies or practices, they most commonly turned to shareholder resolution or proposals at annual meetings.<sup>67</sup> These proposals are recommendations for corporate action that are drafted by the shareholders themselves, which are then included in the corporate proxy statements and

59. Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1745 (2006).

60. *Id.*

61. Joel Slawotsky, *The Virtues of Shareholder Value Driven Activism: Avoiding Governance Pitfalls*, 12 HASTINGS BUS. L.J. 521, 522 (2016) (citing John Armour & Brian Cheffins, *Offensive Shareholder Activism in U.S. Public Companies, 1900–49* (Univ. of Cambridge Fac. of L. Legal Stud. Rsch. Paper Series, Paper No. 09/2011, 2011)).

62. *Id.* (citing John Armour & Brian Cheffins, *Offensive Shareholder Activism in U.S. Public Companies, 1900–49* 1 (Univ. of Cambridge Fac. of L. Legal Stud. Rsch. Paper Series, Paper No. 09/2011, 2011)).

63. *Id.* at 522–23 (Barbara Kiviat, *10 Questions for Carl Icahn*, TIME (Feb. 15, 2007), <http://content.time.com/time/magazine/article/0,9171,1590446,00.html> [<https://perma.cc/27M3-VYUK>]).

64. *Id.* at 523 (citing Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV., Jan.–Feb. 1994, <https://hbr.org/1994/01/institutional-investors-the-reluctant-activists> [<https://perma.cc/M2PB-5SSG>]).

65. *Id.* (quoting Sharon Hanes, *Brave New World: A Proposal for Institutional Investors*, 16.1 THEORETICAL INQUIRIES L. 245, 258–59 (2015)).

66. See Slawotsky, *supra* note 61, at 524 (quoting *An Investor Calls*, ECONOMIST (Feb. 7, 2015), <http://www.economist.com/news/briefing/21642175-sometimes-ill-mannered-speculative-and-wrong-activists-are-rampant-they-will-change-american> [<https://perma.cc/LS9H-HCGK>]).

67. See Sarah A. Soule, *Social Movements and Their Impact on Business and Management*, OXFORD RSCH. ENCYC. BUS. & MGMT. (Mar. 28, 2018), <https://oxfordre.com/business/view/10.1093/acrefore/9780190224851.001.0001/acrefore-9780190224851-e-143?print=pdf> [<https://perma.cc/66PZ-48LB>]; see also HAYAGREEVA RAO, MARKET REBELS: HOW ACTIVISTS MAKE OR BREAK RADICAL INNOVATIONS ch. 5 (2009); Richard Marens, *Inventing Corporate Governance: The Mid-Century Emergence of Shareholder Activism*, 8 J. BUS. & MGMT. 365, 365 (2002) (discussing tactics employed by shareholder activists).

submitted to all the shareholders for a vote.<sup>68</sup> According to the Securities Exchange Commission (SEC), the shareholder proposal process is “popular because it provides an avenue for communication between shareholders and companies, as well as among shareholders themselves.”<sup>69</sup> This mechanism, as it is known today, came into existence when the SEC adopted a rule mandating disclosure of shareholder proposals in 1942—section 14(a) of the Securities and Exchange Act.<sup>70</sup>

Shareholders have shifted from a traditionally apathetic role to being highly active and influential in important corporate matters.<sup>71</sup> Recently, shareholder activism has drastically increased.<sup>72</sup> Between 2010 and 2019, a record number of shareholder proposals were submitted.<sup>73</sup> These proposals were “aimed at enhancing [shareholder] influence over director elections and corporate affairs.”<sup>74</sup> Social media, press campaigns, and investor and shareholder proposals have been the primary tools traditionally used by private stakeholders to persuade companies to change behavior.<sup>75</sup> Interestingly, while shareholder proposals are typically filed by individual shareholders, increasingly they have been filed by coalitions of social movement organizations who have obtained stock in numerous companies in order to exert leverage over them.<sup>76</sup>

Today, shareholder activism is “a mainstream strategic investment tactic[.]”<sup>77</sup> These activists have presented corporations with a wide variety of demands.

Activist [shareholders] . . . campaign[] against public company targets by taking large stock positions and then publicly agitating for changes, such as stock repurchases, extraordinary dividends, dispositions of

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68. Michele Benedetto Neitz, *Hobby Lobby and Social Justice: How the Supreme Court Opened the Door for Socially Conscious Investors*, 68 SMU L. REV. 243, 253–54 (2015) (first citing LISA M. FAIRFAX, *SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION* 64 (2011); and then citing 17 C.F.R. § 240.14a-8 (2014)).

69. *Id.* at 254 (quoting JAY EISENHOFER & MICHAEL BARRY, *THE HISTORY OF SHAREHOLDER ACTIVISM* 3–9 (Supp. 2007)).

70. *Id.* (citing LISA M. FAIRFAX, *SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION* 65 (2011)).

71. See Fairfax, *supra* note 54, at 1304–05.

72. *Id.* at 1314–16.

73. *Id.* at 1320.

74. *Id.*

75. See, e.g., CLEARLY GOTTLIEB, *SHAREHOLDER COMPLAINTS SEEK TO HOLD DIRECTORS LIABLE FOR LACK OF DIVERSITY* 5–6 (2020), <https://client.clearlygottlieb.com/51/1802/uploads/2020-07-24-shareholder-complaints-seek-to-hold-directors-liable-for-lack-of-diversity.pdf> [<https://perma.cc/U7VK-X6EU>] [hereinafter *SHAREHOLDER COMPLAINTS*].

76. See Soule, *supra* note 67, at 4.

77. See Slawotsky, *supra* note 61, at 528.

non-core businesses or an outright sale of the company. There is often an implicit or explicit threat of a proxy contest to remove some or all of the target board members and management if their demands are not met. Ultimately, the activist may receive one or more seats on the target company board, either through a settlement with the target or success at a stockholder meeting.<sup>78</sup>

Additionally, there has been a rise in calls for greater engagement with the board and officers outside of the traditional proposal process and annual meeting<sup>79</sup>—which did not exist twenty-five years ago.<sup>80</sup> For example, 77% of S&P 500 companies disclosed engagement with shareholders in 2018, whereas only 56% disclosed engagement with shareholders in 2015.<sup>81</sup>

It is worth noting that numerous scholars have suggested that shareholder activism can have negative effects.<sup>82</sup> Many shareholders remain uninformed, but even informed shareholders may cause issues. Different factions of shareholders may have significantly different goals.<sup>83</sup> For example, a shareholder may prioritize a political agenda over maximizing a corporation's value.<sup>84</sup> Therefore, some scholars argue active shareholder involvement in corporate decision making may disrupt a corporation by taking power away from centralized and well-informed corporate boards.<sup>85</sup>

78. *Id.* (quoting Mark D. Gerstein, *Hushmail: Are Activist Hedge Funds Breaking Bad?*, HARV. L.F. ON CORP. GOVERNANCE & FIN. REG. (July 7, 2014), <https://corpgov.law.harvard.edu/2014/07/07/hushmail-are-activist-hedge-funds-breaking-bad/#more-64293> [<https://perma.cc/397F-VBY6>]).

79. Fairfax, *supra* note 54, at 1320 (citing Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 833 (2013); James Kim & Jason D. Schloetzer, Conference Bd., *Global Trends in Board-Shareholder Engagement*, DIRECTOR NOTES 1 (2013), <https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2618> [<https://perma.cc/F8C7-HAQF>]).

80. *Id.* (citing Susan S. Boren et al., *Why They Still Do It: Directors' Motivations for Joining a Board*, SPENCER STUART (2010), <https://www.spencerstuart.com/research-and-insight/why-they-still-do-it-understanding-directors-motivations-for-joining-a-board> [<https://perma.cc/XT2W-V6M2>]).

81. *Id.* at 1321 (citing EY CTR. FOR BD. MATTERS, 2018 PROXY SEASON REVIEW 4 (July 2018), [https://www.ey.com/Publication/vwLUAssets/EY-cbm-proxy-season-review-2018/\\$FILE/EY-cbm-proxy-season-review-2018.pdf](https://www.ey.com/Publication/vwLUAssets/EY-cbm-proxy-season-review-2018/$FILE/EY-cbm-proxy-season-review-2018.pdf) [<https://perma.cc/M8YZ-JK59>]).

82. See George W. Dent, *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 100–05 (2010) (describing several issues that numerous scholars have noted about different activist shareholders). Even when scholars have found that shareholder activism can lead to short-term gains for a corporation, they have questioned whether these short-term gains actually produce long-term improvements for the corporation. See Matthew D. Cain, Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649, 698–99 (2016).

83. Dent, *supra* note 82, at 100–01.

84. *Id.* at 102.

85. Bainbridge, *supra* note 59, at 1740, 1749.

However, disruption may not always cause the corporation harm and in fact, the goal in recent shareholder activism appears to be disruption.

While traditional tactics continue to be used, there is a new trend in mobilizing change: diversity driven shareholder derivative suits. Starting in July 2020, a frenzy of diversity driven derivative suits were filed against the boards and officers of high-profile public companies alleging boards and officers breached their fiduciary duties by failing to fulfill their diversity initiatives.<sup>86</sup> This is the latest initiative by shareholders to drive companies to make change.

## B. Holding Companies Accountable Through Derivative Suits

### 1. *The Derivative Suit*

Directors and officers of a public corporation owe fiduciary duties to their company.<sup>87</sup> When corporate boards or officers have breached their fiduciary duties and the company is harmed by that breach, a shareholder can bring a derivative suit naming its board and officers as defendants.<sup>88</sup> The suit is “derivative” because the shareholder is not bringing the suit directly, but rather, on behalf of the company.<sup>89</sup> “The derivative action is practically the only remedy for calling the management to account for its wrongs against the corporation and to obtain restitution.”<sup>90</sup> Derivative suits permit an individual shareholder to bring suit to “enforce a *corporate* cause of action against officers, directors, and third parties.”<sup>91</sup> Therefore, any monetary damages awarded to the shareholder plaintiff are paid to the corporation, not the individual shareholder.<sup>92</sup>

Derivative suits are mainly used as a mechanism for accountability:<sup>93</sup> “the purpose of the derivative action [is] to place in the hands of the

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86. Pamela S. Palmer et al., *A New Wave of Board Diversity Derivative Litigation*, TROUTMAN PEPPER (Oct. 21, 2020), <https://www.troutman.com/insights/a-new-wave-of-board-diversity-derivative-litigation.html> [<https://perma.cc/S3S4-8F75>].

87. Denise M. Alter, *Corporate Art Collecting and Fiduciary Duties to Shareholders: Legal Duties and Best Practices for Directors and Officers*, 2009 COLUM. BUS. L. REV. 1, 7 (2009).

88. See Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 82 (2008).

89. David W. Locascio, Comment, *The Dilemma of the Double Derivative Suit*, 83 NW. U. L. REV. 729, 729 (1989).

90. *Pearce v. Superior Ct.*, 197 Cal. Rptr. 238, 242 (Cal. Ct. App. 1983).

91. *Ross v. Bernhard*, 396 U.S. 531, 534 (1970) (emphasis added).

92. Erickson, *supra* note 88, at 81.

93. John Matheson, *Restoring the Promise of the Shareholder Derivative Suit*, 50 GA. L. REV. 327, 330–31 (2016). See *id.* at 330 n.6 (citing 2 AM. LAW INST., PRINCIPLES OF CORPORATE

individual shareholder a means to protect the interests of the corporation from the misfeasance and malfeasance of ‘faithless directors and managers.’”<sup>94</sup> Shareholder derivative suits have long been recognized as a way for shareholders to hold directors and officers accountable for misconduct:

[A] stockholder is not powerless to challenge director action which results in harm to the corporation. The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management. The derivative action developed in equity to enable shareholders to sue in the corporation’s name where those in control of the company refused to assert a claim belonging to it.<sup>95</sup>

That accountability seeks two main goals: (1) to recover monetary damages on behalf of the company due to the directors’ or officers’ wrongful acts; and (2) to promote improved corporate governance by requiring the corporation to change policy and practices.<sup>96</sup>

## 2. *Mechanism of Derivative Suits*

Derivative suits are a matter of state corporate law.<sup>97</sup> As such, the controlling law depends upon where a company is incorporated.<sup>98</sup> However, most states have specific prerequisites and high pleading standards for derivative suits.<sup>99</sup> The most important pre-filing requirement is that the

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GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 5–6 (1994)) (“The derivative suit is not the only means to maintain management accountability.”).

94. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991) (quoting *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 548 (1949)).

95. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984), *overruled by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

96. See KESSLER TOPAZ MELTZER & CHECK, LLP, A PRIMER ON SHAREHOLDER LITIGATION 97 (Oct. 2019), [https://www.ktmc.com/files/22946\\_primer\\_10\\_2019.pdf](https://www.ktmc.com/files/22946_primer_10_2019.pdf) [<https://perma.cc/LXF2-DDB6>] (“The objectives of these actions are primarily twofold: (i) to recover from wrongdoers monetary damages for the company; and (ii) to require the company to adopt corporate governance improvements designed to prevent the complained of harmful conduct from occurring again in the future.”).

97. E. Norman Veasey & Michael P. Dooley, *The Role of Corporate Litigation in the Twenty-First Century*, 25 DEL. J. CORP. L. 131, 145 (2000).

98. *Id.*; see Demetrios G. Kaouris, Note, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 966 (1995) (stating that entities incorporate in states with suitable law for their business needs).

99. See Palmer et al., *supra* note 86.



shareholder plaintiff made a “demand” on the board or officers, and if they did not, the shareholder plaintiff must demonstrate the demand would be “futile.”<sup>100</sup> Rule 23.1 of Federal Rule of Civil Procedure states in relevant part:

The complaint [in a shareholder derivative action] . . . must state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort.<sup>101</sup>

The derivative complaint therefore requires a shareholder plaintiff to demonstrate with specificity: (1) the shareholder plaintiff made a pre-suit demand on the board, which the board wrongfully refused; and (2) the reason for not obtaining the action or not making the effort.<sup>102</sup> The board’s refusal of the demand is “subject only to the deferential ‘business judgment rule,’<sup>103</sup> standard of review”<sup>104</sup> and is presumed valid, unless the shareholder plaintiff can rebut the presumption.<sup>105</sup> In order to rebut this presumption, the shareholder plaintiff must allege demand futility—the directors are incapable of making an impartial business judgment on a demand.<sup>106</sup> This could be accomplished by alleging that the board “(a) [is] not independent of allegedly culpable actors, or (b) face[s] a substantial likelihood of personal

100. Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 780 (2002).

101. FED. R. CIV. P. 23.1(b)(3).

102. *See id.*

103. The business judgment rule “is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 411 (2013) (quoting *Parnes v. Bally Ent. Corp.*, 722 A.2d 1243, 1246 (Del. 1999); *Aronson*, 473 A.2d at 812). The business judgment rule is a principle of judicial review—rather than a rule of conduct—under which courts grant the decisions of corporate directors greater deference. Elizabeth S. Miller & Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 344 (2005).

104. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 101 (1991) (citing *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 & n.10 (Del. 1981)).

105. *See* Aaron D. Jones, *Corporate Officer Wrongdoing and the Fiduciary Duties of Corporate Officers under Delaware Law*, 44 AM. BUS. L.J. 475, 481–82 (2007). *But compare* *Pearce v. Superior Court*, 197 Cal. Rptr. 238, 242 (Cal. Ct. App. 1983), where the court acknowledged boards and officers would not want to take action against themselves: “Where a derivative suit is against outsiders for wrongs against the corporation the directors can usually be expected to decide impartially on the advisability of suing. But the management cannot be expected to sue themselves for their own misdeeds.” *Id.*

106. *See* Palmer et al., *supra* note 86.

liability themselves.”<sup>107</sup> Such allegations would include “bad faith, intentional wrongdoing, facts showing that the board ‘utterly failed to implement any reporting or information system or controls’ or ‘knew evidence of corporate misconduct’ (red flags) and ‘consciously disregarded’ a duty to act.”<sup>108</sup> Alternatively, if the demand was not provided, the shareholder plaintiff must demonstrate the demand would be futile by providing “‘particularized facts’ that create a reasonable doubt that (1) the directors are disinterested and independent and (2) the board’s decision (approval of the compensation package) is not otherwise protected by the ‘business judgment rule’ . . . .”<sup>109</sup> Because of the high pleading requirements and burden shifting, many derivative suits are dismissed at the pleading stage.<sup>110</sup>

### 3. *The Newbie Derivative Suit*

In 2020, the uprising of the BLM movement sparked a national dialogue about race relations, diversity, equity, inclusion, and justice.<sup>111</sup> The focus on DEIJ created a new legal theory for derivative suits: Boards and officers have breached their fiduciary duties by failing to diversify their board of directors, despite statements of commitment to DEIJ.<sup>112</sup> In the months following George Floyd’s murder, several derivative suits were filed against big names, such as Facebook, Cisco, Oracle, Qualcomm, NortonLifeLock, The Gap, and Monster Beverages.<sup>113</sup>

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107. *Id.*

108. *Id.* (citing *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996)).

109. See Bebchuk et al., *supra* note 100, at 780–81.

110. See *id.* at 781 (“Creating a reasonable doubt about either can be difficult for shareholders to accomplish early in the litigation, especially because the plaintiff has not had the opportunity to conduct discovery.”).

111. See Jose A. Del Real, Robert Samuels & Tim Craig, *How the Black Lives Matter Movement Went Mainstream*, WASH. POST (June 9, 2020), [https://www.washingtonpost.com/national/how-the-black-lives-matter-movement-went-mainstream/2020/06/09/201bd6e6-a9c6-11ea-9063-e69bd6520940\\_story.html](https://www.washingtonpost.com/national/how-the-black-lives-matter-movement-went-mainstream/2020/06/09/201bd6e6-a9c6-11ea-9063-e69bd6520940_story.html) [<https://perma.cc/3LQP-DXTY>].

112. See Kristen Seeger, Alexa Perez & Nilofer Umar, *The Black Lives Matter Movement’s Implications for Shareholder Derivative Litigation*, THE AMLAW LITIG. DAILY (Oct. 28, 2020), <https://www.sidley.com/-/media/publications/amlaw-litigation-daily-1028.pdf?la=en> [<https://perma.cc/64P6-3WRZ>].

113. See Louise Renne, *Seven Shareholder Derivative Lawsuits Seek Diversity on Corporate Boards*, RENNE PUB. L. GRP. (Sept. 29, 2020), <https://rennepubliclawgroup.com/seven-shareholder-derivative-lawsuits-seek-diversity-on-corporate-boards/> [<https://perma.cc/HKG9-MVUE>]; see also Kevin M. LaCroix, *The Gap Hit with Board Diversity Derivative Lawsuit*, D&O DIARY (Sept. 2, 2020), <https://www.dandodiary.com/2020/09/articles/director-and-officer->

Each of these companies has a history of publishing statements promoting diversity, equity, and inclusion, and each company's actions are alleged to fall short of these statements.<sup>114</sup> According to the complaints, these companies failed to meet those published statements.<sup>115</sup> Based on those statements, the core allegations of these claims include breach of fiduciary duties, unjust enrichment, and misstatement and misrepresentation of proxy statements (in violation of section 14(a) of the Securities Exchange Act of 1934).<sup>116</sup>

*a. The diversity-derivative suit model*

While each complaint alleges specific facts relevant to each company, there are several similar allegations made in each complaint, and plaintiffs seek similar relief.<sup>117</sup> For example, in the Facebook, Oracle, and Qualcomm complaints, the reasons for liability asserted against the directors and officers include that they: (1) breached their fiduciary duty by failing to take steps to prevent violations of anti-discrimination laws; (2) breached their fiduciary duties by failing to ensure diverse candidates were placed on the board; (3) authorized false statements in proxy statements; and (4) “overcompensated themselves at the expense of minority and women employees. . . .”<sup>118</sup>

Additionally, in each of the three complaints, the plaintiffs are seeking similar remedies. These remedies include: “multi-million-dollar corporate donations to organizations supporting minority advancement, financial commitments to programs to hire, promote, and retain diverse talent, as well as investments in a diverse personnel talent pipeline”; “requiring diversity training for board members”; “setting new corporate goals and policies for diverse hiring practices”; “publishing annual diversity reports, compensatory damages, punitive damages”; and “calling for corporate

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liability/the-gap-hit-with-board-diversity-derivative-lawsuit/ [https://perma.cc/97LF-BDME] (discussing a derivative suit filed against The Gap).

114. See Palmer et al., *supra* note 86.

115. See STEPHANIE RESNICK & JOHN C. FULLER, DIVERSITY, EQUITY, AND INCLUSION: MEETING NEW DEMANDS—AND REQUIREMENTS—FOR ACCOUNTABILITY, 2021 BD. LEADERSHIP 4, 4 (2021), <https://onlinelibrary-wiley-com.proxyiub.uits.iu.edu/doi/full/10.1002/bl.30184> [https://perma.cc/KJ25-MYBB].

116. *Id.*

117. See generally Verified Shareholder Derivative Complaint, Klein *ex rel.* Oracle Corp. v. Ellison, No. 3:20-cv-04439 (N.D. Cal. July 2, 2020) [hereinafter Oracle Complaint]; Verified Shareholder Derivative Complaint, Ocegueda *ex rel.* Facebook, Inc. v. Zuckerberg, 526 F. Supp. 3d 637 (No. 3:20-cv-04444) (N.D. Cal. July 2, 2020) [hereinafter Facebook Complaint]; Verified Shareholder Derivative Complaint, Kiger *ex rel.* Qualcomm Inc. v. Mollenkopf, No. 3:20-cv-01355 (S.D. Cal. July 17, 2020) [hereinafter Qualcomm Complaint].

118. See SHAREHOLDER COMPLAINTS, *supra* note 75, at 2.

board reform (including removal of existing board members to make way for new, diverse members) and claw-back of board compensation[.]”<sup>119</sup>

*b. Facebook’s derivative suit*

Taking a detailed look at the Facebook complaint provides a greater understanding to this new trend of diversity-derivative suits. In *Ocegueda v. Zuckerberg*, the shareholder plaintiff brought a shareholder derivative action on behalf of Facebook and against present and former directors and officers.<sup>120</sup> According to the complaint, the board breached their fiduciary duties by failing to monitor the company’s compliance with anti-discrimination laws related to hate speech and housing discrimination.<sup>121</sup> This failure resulted in “massive boycott[s] by advertisers”<sup>122</sup> and lawsuits against the company, including a lawsuit filed by the U.S. Department of Housing and Urban Development.<sup>123</sup> Consequently, Facebook lost revenue and incurred increased litigation costs.

Several portions of the complaint focus on Facebook’s proxy statements.<sup>124</sup> In accordance with the Securities Exchange Act of 1934, every public company must file a proxy statement before shareholder meetings.<sup>125</sup> The proxy statement discloses material matters of the company so that their shareholders can understand how to vote at shareholder meetings and make informed decisions about how to delegate their votes.<sup>126</sup> Section 14(a) of the Exchange Act prohibits a proxy statement from “containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading...”<sup>127</sup> Simply put, it prohibits material misrepresentations and misleading statements.

119. Palmer et al., *supra* note 86.

120. Facebook Complaint, *supra* note 117, at 1.

121. *See id.* ¶¶ 54–55.

122. *Id.* ¶¶ 55.

123. *See id.* ¶¶ 65–67, 80–84.

124. *See, e.g., id.* ¶ 25 (noting “[p]latitudes in proxy statements are not progress.”).

125. *See Proxy Statement*, U.S. SEC. & EXCH. COMM’N (Sept. 8, 2011), <https://www.sec.gov/answers/proxy.htm> [<https://perma.cc/MYM9-NB2S>].

126. *See Annual Meetings and Proxy Requirements*, U.S. SEC. & EXCH. COMM’N (Apr. 28, 2022), <https://www.sec.gov/smallbusiness/goingpublic/annualmeetings> [<https://perma.cc/6VXN-AXS7>]. Proxy statements can include diversity data. *See* Sanjay M. Shirodkar & Rita M. Patel, *2019 Proxy Season Hot Topics: Part 4 – Diversity disclosure and executive compensation*, DLA PIPER (Feb. 21, 2019), <https://www.dlapiper.com/en/us/insights/publications/2019/02/2019-proxy-season-hot-topics-part-4/> [<https://perma.cc/6ELU-7S6X>].

127. 17 C.F.R. § 240.14a-9(a) (2020).

According to the Facebook complaint, the company repeatedly stated its commitment to diversity and inclusion, and the plaintiff points to language in the 2019 and 2020 Proxy Statements about the company's commitment to diversity and inclusion in their workplace and on the board.<sup>128</sup> For example, Facebook's 2019 Proxy statement included a section devoted to Diversity & Inclusion which included, in part, the following statements:

We are committed to building a workforce that is as diverse as the communities we serve. We support an open culture and encourage our workforce to bring their authentic selves to work.

....

We are committed to a policy of inclusiveness and to pursuing diversity in terms of background and perspective when evaluating candidates for membership on our board of directors. Under our corporate governance guidelines, it is the policy of our board of directors to consider candidates with diverse backgrounds in terms of knowledge, experience, skills, and other characteristics, and to ensure that the initial list of candidates from which new director nominees are chosen includes candidates with a diversity of race, ethnicity, and gender.<sup>129</sup>

The complaint asserts these statements were materially false and misleading when measured against the lack of racial diversity among board and officers.<sup>130</sup> Further, according to the complaint, Facebook also made similar statements in opposition to shareholder proposals.<sup>131</sup> Plaintiff alleged that combined, all these statements were misleading and materially false, enabling directors to win reelection and the company to defeat the shareholder proposals.<sup>132</sup>

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128. See Verified Shareholder Derivative Complaint, *supra* note 117, ¶¶ 100–04, 129–321, Ocegueda *ex rel.* Facebook, Inc. v. Zuckerberg, 526 F. Supp. 3d 637 (No. 3:20-cv-04444) (N.D. Cal. July 2, 2020).

129. Facebook, Inc., *Proxy Statement* 48, U.S. SEC. & EXCH. COMM'N (Apr. 12, 2019), <https://www.sec.gov/Archives/edgar/data/1326801/000132680119000025/facebook2019definitiveprox.htm> [<https://perma.cc/2MJD-A84S>].

130. See Facebook Complaint, *supra* note 117, ¶¶ 100–04, 121(b)–(d), 129–31.

131. See *id.* ¶¶ 105–06, 110–11.

132. See *id.* ¶ 245.

According to the plaintiff, Facebook's Compensation, Nominating and Governance Committee (the "Committee") failed to fulfill its fiduciary duty to ensure diversity on the board.<sup>133</sup> Plaintiff alleged Facebook's Committee charter required the Committee to evaluate board composition and performance, as well as seek and nominate diverse board candidates.<sup>134</sup> The complaint alleges that members of the Committee failed to follow the charter and breached their fiduciary duties by failing to recommend well-qualified minority candidates for board seats.<sup>135</sup>

As mentioned previously, plaintiffs in these derivatives suits are seeking similar remedies. Specific to Facebook, the complaint demands in part:<sup>136</sup> the replacement of at least three current directors "with two Black persons and one other minority";<sup>137</sup> the "creation of a \$1 billion fund to hire Black and minority employees" while mentoring, promoting, and retaining Black and minority employees;<sup>138</sup> the requirement of annual training of the board and executives focused on "diversity, affirmative action, anti-discrimination and anti-harassment" topics;<sup>139</sup> the publication of an augmented annual diversity report with particularized information about equitable treatment of employees;<sup>140</sup> and the adoption of an executive compensation program making "30% of executives' compensation tied to the achievement of the diversity goals."<sup>141</sup> Further, the plaintiff demanded all named directors to return all their 2020 compensation from Facebook and donate the money to a charity or organization dedicated to advancing Black people and other minorities in corporate America.<sup>142</sup>

### *c. Weaknesses in the new wave*

Experts are quick to list the weaknesses of this wave of diversity driven derivative suits. With the high pleading requirements derivative suits carry, plaintiffs need to clear several hurdles. The first is the demand requirement: plaintiffs must have made a demand to the board or officers that the board

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133. See Verified Shareholder Derivative Complaint ¶¶ 145–46, *Ocegueda ex rel. Facebook, Inc. v. Zuckerberg*, 526 F. Supp. 3d 637 (No. 3:20-cv-04444) (N.D. Cal. July 2, 2020).

134. See *id.* ¶¶ 145–46.

135. See *id.* ¶ 146.

136. For a full list of remedies sought, see *id.* at 83–86 ¶¶ A–G.

137. *Id.* at 84, ¶ B(1).

138. See *id.* at 84, ¶ B(5).

139. Verified Shareholder Derivative Complaint at 84–85, ¶ B(6), *Ocegueda ex rel. Facebook, Inc. v. Zuckerberg*, 526 F. Supp. 3d 637 (No. 3:20-cv-04444) (N.D. Cal. July 2, 2020).

140. See *id.* at 84, ¶ B(4).

141. See *id.* at 85, ¶ B(7).

142. See *id.* at 84, ¶ B(3).

improperly refused; otherwise, the plaintiffs must demonstrate that they did not make a demand because it would have been futile. Notwithstanding one case,<sup>143</sup> each set of plaintiffs did not make a demand to the board prior to filing suit but instead relied on allegations of demand futility.<sup>144</sup> Consequently, in order to meet the first pleading requirement, plaintiffs need to demonstrate the very difficult requirement of demand futility.<sup>145</sup>

Additionally, plaintiffs have a difficult time calculating damages to the company caused by lack of diversity on boards with any reliability the court may require.<sup>146</sup> Plaintiffs' damages arguments ride on ideas such as the company's failure to ensure diversity triggered negative consequences to the bottom line<sup>147</sup> and that greater board diversity would lead to *more* profits.<sup>148</sup> While reports routinely find workplace, executive, and board diversity increases performance and profitability,<sup>149</sup> there is no *guarantee* increasing diversity on boards for the named defendants would result in higher profits, or what those profits would be. Since the boards have broad immunity related to business decisions under the business judgment rule, this may not be a winning argument for the plaintiffs to rebut the presumption of validity the board's actions are afforded.<sup>150</sup>

Procedurally, defendants have quickly pointed to the forum selected by plaintiffs. The majority of the derivative suits were filed in California federal courts.<sup>151</sup> Several of the companies have charters clearly stating that the state

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143. The pleadings in a derivative suit filed against Cisco's board of directors included a pre-suit demand made to the board prior to filing suit. See Palmer et al., *supra* note 86.

144. See *id.*

145. See *supra* Subsection II.B.2 for a thorough explanation of the demand requirement and how a plaintiff can demonstrate demand futility.

146. See Palmer et al., *supra* note 86.

147. See *id.*

148. *Id.*

149. See VIVIAN HUNT ET AL., DELIVERING THROUGH DIVERSITY, MCKINSEY & CO. 1–2 (2018), [https://www.mckinsey.com/~media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity\\_full-report.ashx](https://www.mckinsey.com/~media/mckinsey/business%20functions/organization/our%20insights/delivering%20through%20diversity/delivering-through-diversity_full-report.ashx) [<https://perma.cc/N8X5-WLWG>]; see also MIKI TSUSAKA ET AL., DIVERSITY AT WORK, BOS. CONSULTING GRP. 2–5 (2017), <https://www.bcg.com/en-us/publications/2017/diversity-at-work> [<https://perma.cc/S48M-EU2N>] (discussing the results of a BCG study); ROCÍO LORENZO, ET AL., THE MIX THAT MATTERS, BOS. CONSULTING GRP. 5–7 (2017), <https://www.bcg.com/publications/2017/people-organization-leadership-talent-innovation-through-diversity-mix-that-matters> [<https://perma.cc/2JMK-E5VL>] (discussing the same).

150. See *supra* Subsection II.B.2 for a discussion on the business judgment rule standards of review and presumption of validity.

151. See cases cited *supra* note 117; see also *Is Diversity the Next D&O Risk?*, CFC (Feb. 10, 2021), <https://www.cfcunderwriting.com/en-us/resources/articles/2021/02/is-diversity-the-next-do-risk/> [<https://perma.cc/MT62-9FUY>] (noting several lawsuits were filed against high-profile companies in California courts).

of incorporation is the “exclusive” forum for derivative suits.<sup>152</sup> Facebook’s charter states that the State of Delaware is:

the sole and exclusive forum for (1) any derivative action or proceeding brought on behalf of the corporation, (2) any action asserting a claim of breach of a fiduciary duty owed by, or other wrongdoing by, any director, officer, employee or agent of the corporation to the corporation or the corporation’s stockholders. . . .<sup>153</sup>

Critics may be correct—at the time of writing, three of the high profile cases have been dismissed: Facebook’s derivative suit,<sup>154</sup> which was soon followed by The Gap’s,<sup>155</sup> and then Oracle’s.<sup>156</sup> In granting the defendants’ motion to dismiss in the Facebook case, the court ruled the plaintiff did not meet the demand futility requirement; the forum selection clause required filing in Delaware and not California; and the plaintiff did not “plausibly plead” material false statement in the Proxy statements.<sup>157</sup> In The Gap dismissal, the judge granted the motion based on the forum selection clause and did not make other rulings on the merits.<sup>158</sup> Consistent with the first two dismissals, the judge in the Oracle case ruled that the plaintiffs needed to file in Delaware and further ruled that plaintiffs failed to meet the demand futility requirement and failed to sufficiently assert the Proxy statements were false or misleading.<sup>159</sup>

As of August 2021, a number of these derivative suits remain pending. For example, in the Cisco case, where the plaintiff did make a pre-suit demand on the defendants, following the filing of the derivative suit, defendants responded to the derivative complaint with a motion to dismiss

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152. See SHAREHOLDER COMPLIANTS, *supra* note 75, at 4 (noting Oracle’s bylaws and Facebook’s charter).

153. Defendants’ Notice of Motion and Motion to Dismiss Plaintiff’s Verified Shareholder Derivative Complaint, and Memorandum of Points and Authorities in Support at 28, Ocegueda *ex rel.* Facebook, Inc. v. Zuckerberg, 526 F. Supp. 3d 637 (No. 3:20-cv-04444) (N.D. Cal. Oct. 5, 2020).

154. See Kevin LaCroix, *Facebook Board Diversity Lawsuit Dismissal Motion Granted*, D&O DIARY (Mar. 23, 2021), <https://www.dandodiary.com/2021/03/articles/director-and-officer-liability/facebook-board-diversity-lawsuit-dismissal-motion-granted/> [<https://perma.cc/PSG7-SH6D>].

155. Lee v. Fisher, No. 20-cv-06163-SK, 2021 WL 1659842, at \*6 (N.D. Cal. Apr. 27, 2021).

156. Klein v. Ellison, No. 20-cv-04439-JSC, 2021 WL 2075591, at \*4–9 (N.D. Cal. May 24, 2021).

157. Ocegueda *ex rel.* Facebook, Inc. v. Zuckerberg, 526 F.Supp.3d 637, 641 (N.D. Cal. 2021).

158. Lee, 2021 WL 1659842, at \*6.

159. Klein, 2021 WL 2075591, at \*1.



and a motion to terminate.<sup>160</sup> The defendant's motions claimed the board performed "a reasonable and good faith investigation" into the plaintiff's demand and the resulting rejection was "entitled to deference under the business judgment rule."<sup>161</sup> In response, the plaintiff requested discovery.<sup>162</sup> On June 24, 2021, the presiding Magistrate Judge in the Northern District of California ordered discovery in the Cisco case, holding that the evidence offered by the defendant was a "complete black box that provides no meaningful assessment of what the investigation found, [and therefore] necessitates discovery."<sup>163</sup> Furthermore, the biggest issue for plaintiffs in previously dismissed derivative suits rested mainly on the forum selection clauses found in the company's charters.<sup>164</sup> The remaining cases may have different results, as some do not have forum selection clauses.<sup>165</sup> However, no matter the outcome of these cases, it is important to recognize how these suits, win or lose, affect D&O insurance and therefore, boards and directors.

## C. How Businesses Are Insured

### 1. *The D&O Policy*

In order to protect the board of directors and officers against shareholder litigation,<sup>166</sup> corporations purchase D&O insurance.<sup>167</sup> D&O insurance protects (1) the directors and officers from having to pay personal assets when they are found personally liable for something; and (2) the assets of the

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160. Keith Bishop & Allen Matkins, *Court Orders Discovery In Derivative Action Challenging Racial Diversity*, JD SUPRA (Aug. 10, 2021), <https://www.jdsupra.com/legalnews/court-orders-discovery-in-derivative-2298785/> [<https://perma.cc/U283-7M3C>].

161. *City of Pontiac Gen. Emps. Ret. Sys. v. Bush*, No. 20-cv-06651-JST, 2021 WL 2588979, at \*2 (N.D. Cal. June 24, 2021).

162. Bishop & Matkins, *supra* note 160.

163. *Bush*, 2021 WL 2588979, at \*6.

164. See LaCroix, *supra* note 154.

165. *Id.*

166. Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1801 (2007). Shareholder litigation covered by D&O insurance includes securities law claims as well as direct and derivative fiduciary claims. *Id.* at 1803.

167. *Id.* at 1801.

corporation.<sup>168</sup> Typically, those protections are through three core agreements called Side A, Side B, and Side C, or “A-B-C coverage.”<sup>169</sup>

*Side A:* The “personal protection” part of the policy acts as professional liability insurance by providing reimbursement for losses or defense costs in the event an insured individual suffers a loss as a result of a legal action.<sup>170</sup> It protects the assets of an individual director or officer for claims the company cannot or will not indemnify the individual.<sup>171</sup> Side A is not subjected to self-insured retention (SIR)<sup>172</sup> or deductible. Historically, Side A coverage would apply when a corporation was insolvent, and therefore could not indemnify the board or officers.<sup>173</sup> However, many states—like Delaware, where approximately 93% of public companies are registered<sup>174</sup>—prohibit a company from indemnifying directors and officers for any settlement portion of a derivative claim.<sup>175</sup> As derivative suits increase, Side A coverage is becoming increasingly important.<sup>176</sup>

*Side B:* This part of the policy is for the benefit of the company. Side B reimburses a company for its indemnification obligation to its directors and officers.<sup>177</sup> Side B is usually subjected to SIR or a deductible.<sup>178</sup>

*Side C:* Often referred to as the “entity coverage” part of the policy, Side C ensures the corporation is covered when the corporation is also named in the lawsuit.<sup>179</sup> While Side C provides private companies with broad entity

168. See *id.* at 1797; see also *The Who, What & Why of Directors & Officers Insurance*, THE HARTFORD, <https://www.thehartford.com/management-liability-insurance/d-o-liability-insurance/expained> [<https://perma.cc/MK5Q-UV8A>] (last visited Aug. 19, 2021) (noting the specifics of D&O coverage).

169. Baker & Griffith, *supra* note 166, at 1802–03, 1825.

170. See Priya Cherian Huskins, *The ABCs of Your Private Company D&O (Policy Terms)*, WOODRUFF SAWYER (May 7, 2014), <https://woodrufflaw.com/do-notebook/do-abc/> [<https://perma.cc/Y5LU-DPYQ>]; see also Julia Kagan, *Directors and Officers Liability Insurance*, INVESTOPEDIA (Mar. 4, 2022), <https://www.investopedia.com/terms/d/directors-and-officers-liability-insurance.asp> [<https://perma.cc/R3NS-QHT3>]. D&O can extend to defense costs as a result of criminal and regulatory investigations, but it typically does not cover intentional illegal acts. *Id.*

171. Kagan, *supra* note 170.

172. SIR requires the insured to assume the initial costs of the defense expenses, such as defense costs and allowed judgments or settlements, up to the SIR amount.

173. See Baker & Griffith, *supra* note 166, at 1802–03.

174. Jeffrey W. Bullock, 2020 *Annual Report Statistics*, DEL. DIV. CORP. (2021), <https://corpfiles.delaware.gov/Annual-Reports/Division-of-Corporations-2020-Annual-Report.pdf> [<https://perma.cc/5SKK-U9LE>].

175. See e.g., DEL. CODE ANN. tit. 8, § 145(a) (West 2022) (prohibiting indemnification for settlements and judgments “by or in the right of the corporation”).

176. See Baker & Griffith, *supra* note 166, at 1803.

177. *Id.* at 1802.

178. Priya Cherian Huskins, *D&O Liability Insurance: An Overview*, WOODRUFF SAWYER 2 (May 2018), <https://woodrufflaw.com/wp-content/uploads/2018/05/DO-Insurance-Overview-WSCo-Priya-Huskins-2018-5.pdf> [<https://perma.cc/LPZ5-7HFH>].

179. Kagan, *supra* note 170; Baker & Griffith, *supra* note 166, at 1802.

coverage, it only covers security claims for public companies.<sup>180</sup> Similar to Side B, Side C is generally subjected to SIR or a deductible.<sup>181</sup>

In addition to the customary three-core agreement, there are supplemental agreements that can be added to the D&O policy.<sup>182</sup> Specific to derivative suits, Side D provides “Derivative Investigation Coverage.”<sup>183</sup> Side D pays for the costs associated with investigations required during a derivative suit. These costs include the hiring of outside counsel; accounting, financial, and regulatory costs; and the cost of “books and records” requests—all common in derivative suit litigation.<sup>184</sup>

As many scholars routinely mention, D&O insurance has an important role in incentivizing top talent, as well as in recruiting and retaining outside directors and officers.<sup>185</sup> A robust D&O insurance policy reduces fears of being personally liable for a liability claim.<sup>186</sup> However, as derivative suits increase and large settlements are paid out, D&O insurance’s most important role has transformed from helping companies recruit the best board members to becoming a financier of derivative suits.

## 2. Derivative Coverage

As explained previously, when shareholders bring a derivative suit on behalf of the company, the named defendants are often individual directors or officers and the company.<sup>187</sup> While the exact coverage of the D&O

180. See Matthew T. McLellan, *Directors and Officers Liability (D&O)*, MARSH, <https://www.marsh.com/us/services/financial-professional-liability/directors-and-officers-liability.html> [<https://perma.cc/3LWU-K3XS>] (last visited Aug. 19, 2021).

181. Huskins, *supra* note 178.

182. See Lawline, *Sides A, B, C as easy as 1, 2, 3: D&O Insurance Made Clear*, ABOVE THE L. (Sept. 1, 2016), <https://abovethelaw.com/lawline-cle/2016/09/01/sides-a-b-c-as-easy-as-1-2-3-do-insurance-made-clear/> [<https://perma.cc/Z5FS-YPST>].

183. See *Derivative Investigation Coverage*, INT’L RISK MGMT. INST., <https://www.irmi.com/term/insurance-definitions/derivative-investigation-coverage> [<https://perma.cc/787V-QJFA>] (last visited Aug. 21, 2021).

184. See *Derivative Demand Investigation Costs definition*, L. INSIDER, <https://www.lawinsider.com/dictionary/derivative-demand-investigation-costs> [<https://perma.cc/Q69G-9SD9>] (last visited Aug. 20, 2021).

185. See René Otto & Wim Weterings, *D&O Insurance and Corporate Governance: Is D&O Insurance Indicative of the Quality of Corporate Governance in a Company?*, 24 STAN. J.L. BUS. & FIN. 105, 108 (2019) (citing Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors’ & Officers’ Liability Insurance Market*, 74 U. CHI. L. REV. 487, 502 (2007)); see also Noel O’Sullivan, *Insuring the Agents: The Role of Directors’ & Officers’ Insurance in Corporate Governance*, 64 J. RISK & INS. 545, 549 (1997).

186. Otto & Weterings, *supra* note 185, at 108.

187. See *supra* Section II.B; see also Jason Gordon, *Shareholder Derivative Action Process - Explained*, THE BUS. PROFESSOR (Sept. 25, 2021),

insurance is determined by the policy language, the following hypothetical explains how a typical D&O insurance policy would handle a derivative suit filed against the directors and the company.

Imagine: a Delaware-incorporated company has a \$20 million D&O policy with all insuring sides—Side A, Side B, and Side C. Side B and C have an SIR of \$5 million. The company's shareholders file a derivative suit in Delaware alleging the directors breached their fiduciary duties. Ultimately, the case settled on behalf of the directors for \$20 million. Additionally, in the course of litigation, the directors spend \$5 million personally defending themselves in the derivative suit. How does the D&O insurance apply?

First, the company would indemnify the directors for their defense costs. Coverage under Side B of the D&O insurance policy would reimburse the company for the costs of indemnification *after* the SIR or deductible was met. Under this scenario, where the SIR is \$5 million and the defense costs were \$5 million, there are no costs over the SIR, and the D&O insurer would not pay anything to the company.

Second, since Delaware law applies, the settlement amount cannot be indemnified by the company. The company would turn to Side A of the D&O insurance policy for reimbursement of losses that cannot be legally indemnified. Under Side A, there is no SIR or deductible. The total settlement of \$20 million would be covered under Side A and the insurer would pay the \$20 million.

Third, if there had been a company defense element of the derivative suit, Side C would reimburse the company for the costs, subject to the SIR.

Finally, if the policy had a limit on corporate investigations, the company would be responsible for costs incurred over that limit unless they held Side D coverage. Side D would control the coverage amount beyond Side C and reimburse the company for derivative investigation costs up to the limits of Side D.

Derivative suits are a substantial risk to D&O insurers. As explained above, the D&O insurer must reimburse directors and officers for any defense costs less the SIR or deductible. Additionally, when companies cannot or will not indemnify the board and officers, the D&O insurer must pay *all* the settlement costs up to the policy limits, with no application of SIR or deductible. In the previous decade, premiums held steady and were relatively low. On the rare occasion a D&O insurer had to pay out, the

amounts were considered “nuisance values.”<sup>188</sup> However, the recent upsurge of diversity driven derivative suits has jolted the D&O insurance market.

#### D. The Wary Insurer

Even when there are no settlements or judgments paid to the plaintiff, D&O insurance pays for the legal defense.<sup>189</sup> The nature of the D&O policy routinely leads to substantial legal defense costs.<sup>190</sup> Rather than providing the insured with defense counsel, D&O insurance gives the insured the right to select defense counsel and manage their defense. This arrangement significantly limits the insured’s ability to oversee and control costs. With the knowledge that the D&O policy will simply reimburse the insured for their defense costs (subject only to the policy limits), there is little incentive for the insured to oversee and push back on defense costs.<sup>191</sup> Without the ability to push back on defense counsel’s billing, the result is significant payouts for defense costs.<sup>192</sup> Therefore, any derivative suit, whether it is dismissed or not, can be a substantial risk to D&O insurers.

Further, it is important to recognize that derivative suits are notoriously unpredictable.<sup>193</sup> While a number of derivative suits are being dismissed, others are settling for record breaking amounts and leading to sweeping corporate governance reforms—“[f]or example, in 2018-2019, a similar wave of derivative lawsuits focused on #MeToo issues.”<sup>194</sup> A few of these cases settled as the companies agreed to relief similar to the relief being sought in the current wave of diversity cases.<sup>195</sup> Most notably, in September 2020, Alphabet Inc.—Google’s parent corporation—settled its #MeToo

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188. See Priya Cherian Huskins, *Derivative Suits: Newest Threat to Board Members or ‘Same Old-Same Old’?*, WOODRUFF SAWYER (Sept. 25, 2014), <https://woodrufflaw.com/do-notebook/derivative-suits/> [https://perma.cc/98AH-HPRR].

189. Roberta Romano, *What Went Wrong with Directors’ and Officers’ Liability Insurance?*, 14 DEL. J. CORP. L. 1, 8 (1989).

190. See Baker & Griffith, *supra* note 166, at 1814.

191. *Id.*

192. *Id.* Baker and Griffith discuss how the insureds do not care about defense costs when they know the insurer will be paying the bill; they do not go through bills and push back on litigation defense. *Id.* Consequently, litigation costs can be substantial with the D&O insurer having no control over the costs besides the policy limits.

193. See Priya Cherian Huskins, *Five Types of Derivative Suits with Massive Settlements*, WOODRUFF SAWYER (Oct. 13, 2020), <https://woodrufflaw.com/do-notebook/five-derivative-suits-types-massive-settlements/> [https://perma.cc/4CZ3-XSMQ].

194. Palmer et al., *supra* note 86.

195. *Id.*

derivative suit.<sup>196</sup> The settlement provided for an astonishing \$310 million funding commitment by Alphabet, Inc. to DEI over 10 years.<sup>197</sup> The settlement also requires Alphabet, Inc. to create a Diversity, Equity and Inclusion Advisory Council.<sup>198</sup>

More recently, on July 30, 2021, L Brands, the parent company behind Victoria's Secret and Bath & Body Works, settled derivative actions filed against the two entities for \$90 million.<sup>199</sup> Each entity agreed to pay \$45 million and committed to a five-year plan to reform workplace and corporate culture.<sup>200</sup> These reform plans "include maintenance of a diversity council and an adjustment of corporate value statements to explicitly include diversity and equity."<sup>201</sup> In other words, exactly the type of remedies the current wave of derivative suits attempt to achieve.

These recent derivate suit settlements provide an idea on how companies react to plaintiffs possibly clearing the pleading hurdles of derivative suits. If a court rules a plaintiff has cleared the pleading standard, the court has determined either the demand requirement has been met and the board and officer denial was improper or that the demand would be futile. Thus, the court is essentially acknowledging the likelihood of wrongdoing by the board and officers. Therefore, defendants are prone

196. *Id.*; see *Google*, BOTTINI & BOTTINI, INC. (Sept. 25, 2020), <http://www.bottinilaw.com/other-case/google> [<https://perma.cc/Y3CH-3G8B>]. In the case, the complaint alleged that the company's current and former board members and officers participated in or acquiesced to a culture that fostered a long-standing pattern of sexual harassment and discrimination. Consolidated S'holder Derivative Complaint at 2–3, ¶ 1, *In re Alphabet Inc. S'holder Derivative Litig.*, No. 19-CV-341522 (Cal. Super. Ct. Aug. 16, 2019). Plaintiffs alleged the directors' and officers' actions breached their fiduciary duties to shareholders, employees, and users by reputationally and financially damaging the company. *Id.*

197. BOTTINI & BOTTINI, *supra* note 196.

198. See Louise Renne, *Alphabet Inc. Finalizes \$310 Million Settlement for Sexual Harassment Cases*, RENNE PUB. L. GRP. (Sept. 25, 2020), <https://rennepubliclawgroup.com/press-release-alphabet-inc-finalizes-settlement-for-310-million/> [<https://perma.cc/2LLQ-2AY2>].

199. See Joseph Hartunian, *L Brands Settles Derivative Suits*, JD SUPRA (Aug. 4, 2021), <https://www.jdsupra.com/legalnews/l-brands-settles-derivative-suits-5204374/> [<https://perma.cc/R2AL-82KL>]; see also *L Brands Announces Settlement of Stockholder Derivative Claims*, BATH & BODY WORKS (July 30, 2021), <https://bbwinc.gcs-web.com/news-releases/news-release-details/l-brands-announces-settlement-stockholder-derivative-claims> [<https://perma.cc/Z4MS-XH5R>] (announcing the settlement); Victoria's Secret & Co., Current Report (Form 8-K) (July 30, 2021), <https://www.corporatedefensedisputes.com/wp-content/uploads/sites/19/2021/08/settled.pdf> [<https://perma.cc/53Y6-3R84>] (giving notice of the settlement).

200. See Sapna Maheshwari, *L Brands Agrees to New Policies Tied to Sexual Harassment Claims*, N.Y. TIMES (July 30, 2021), <https://www.nytimes.com/2021/07/30/business/victorias-secret-sexual-harassment.html> [<https://perma.cc/4WKA-2DR5>].

201. Hartunian, *supra* note 199.

to settle in derivative suits and even more so if their motions to dismiss fail.<sup>202</sup>

As briefly mentioned, in addition to the unpredictability of derivative suits, most jurisdictions prohibit companies from indemnifying the settlement in derivative suits.<sup>203</sup> Since companies cannot indemnify, the directors and officers are left personally liable for the settlements. This creates an exposure of risk to directors and officers—possibly having to pay settlements through their personal assets. For this reason, D&O insurance plays an imperative role of safeguarding directors’ and officers’ personal assets.<sup>204</sup>

### III. INSURANCE COMPANIES’ UNLIKELY ROLE

As demonstrated in Parts I and II, derivative suits are rising at an alarming rate and consequently, maintaining a robust D&O insurance policy is crucial for directors and officers. Simultaneously, the upsurge in diversity driven derivative suits produces much greater exposure risks for insurance companies. Accordingly, as derivative suits increase, so do insurance premiums and restrictions on coverage—making it harder on companies to maintain that crucial robust coverage. Further, as stakeholders’ demands for DEIJ initiatives and accountability increase, pressure from several angles will lead to additional avenues for derivative suits. D&O insurance underwriters assessing risk play a vital role in determining premiums and coverage allotted to companies based on board and officer behavior. Ultimately, D&O insurers have indirectly become the catalyst for change, holding directors and officers accountable for their DEIJ commitments.

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202. See Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749, 1756, 1826–27 (2010) (finding that nearly all derivative suits settle); see also John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 L. & CONTEMP. PROBS. 5, 9 (1985) (noting that the majority of derivative suits are resolved through settlement).

203. See Robert A. Johnson, *Delaware Prohibits Indemnification of Costs for Settling a Derivative Suit, but the Rules in Other States May Differ*, 14 ANDREWS CORP. OFFICERS & DIRS. LIAB. LITIG. REP., no. 17, May 1999; see also, e.g., DEL. CODE ANN. tit. 8, § 145(a) (2021) (prohibiting indemnification for settlements and judgments “by or in the right of the corporation”).

204. See *The Who, What & Why of Directors & Officers Insurance*, *supra* note 168.

## A. Insurance Companies' Unrest

Historically, derivative suits were relatively uncommon and most resulting settlement costs were insignificant.<sup>205</sup> In fact, in 2014, Woodruff Sawyer, one of the largest insurance brokerage and consulting firms in the nation,<sup>206</sup> assured its clients that it was unnecessary to increase insurance coverage that covered derivative suits because most derivative suits were settled for “nuisance values,” and the majority of insurance limits were robust enough to cover most derivative suit settlements.<sup>207</sup> Further, for more than a decade, underwriters aggressively competed, driving down prices of Side A insurance premiums.<sup>208</sup> However, this new trend of holding boards and officers accountable to their diversity initiatives has flipped the D&O insurance world.<sup>209</sup>

Today, the derivative suit settlement landscape is much different. In 2020, the two highest private plaintiff employment discrimination settlements were shareholder derivative suits: Alphabet, Inc.’s \$310 million settlement and Wynn Resorts, Ltd.’s \$41 million settlement.<sup>210</sup> As previously discussed, 2021 saw L Brands settle derivative suits for a combined total of \$90 million.<sup>211</sup> As noted, while directors and officers are settling these cases for large sums, they are not paying the settlements with their personal assets. But neither are the companies, as they are usually prohibited from indemnifying derivatives claims. Therefore, Side A of D&O insurance is paying the settlement amounts, without any assistance from SIR or deductibles.

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205. See Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 137 & n.12 (2004) (finding approximately 80% of all fiduciary duty claims filed in the Delaware Chancery Court in 1999 and 2000 were class actions challenging board conduct in an acquisition, while only 14% of fiduciary duty claims were derivative suits).

206. *About Us*, WOODRUFF SAWYER, <https://woodruffsaawyer.com/about-us/> [<https://perma.cc/GFM2-927E>] (last visited Aug. 21, 2021).

207. See Huskins, *supra* note 188.

208. WOODRUFF SAWYER, *LOOKING AHEAD 2021: D&O CONSIDERATIONS FOR THE NEXT CALENDAR YEAR 6* (2020), <https://woodruffsaawyer.com/wp-content/uploads/2020/09/DO-Looking-Ahead-Guide-2021.pdf> [<https://perma.cc/Q4LL-E9TZ>].

209. See *D&O Coverage for Lawsuits Alleging Lack of Boardroom Diversity: Is Your Company Protected?*, SAXE DOERNBERGER & VITA, P.C. (Oct. 28, 2020), [https://www.sdvlaw.com/insights\\_view.asp?key=10340](https://www.sdvlaw.com/insights_view.asp?key=10340) [<https://perma.cc/Y9LC-T5CQ>].

210. See Edward Segal, *After Setting A New Record In 2020, Workplace-Related Litigation Will Remain A Source Of Significant Financial Exposure For Employers*, FORBES (Jan. 5, 2021), <https://www.forbes.com/sites/edwardsegal/2021/01/05/after-setting-a-new-record-in-2020-workplace-related-litigation-will-remain-a-source-of-significant-financial-exposure-for-employers/?sh=10655428678b> [<https://perma.cc/VX3F-NBMY>].

211. See Hartunian, *supra* note 199.



Unsurprisingly, insurers are frustrated by this new trend. Because of the unpredictability of derivative suits, determining how much Side A coverage is enough to settle a case is challenging for underwriters.<sup>212</sup> As described by Mary McCutcheon, who advises D&O clients for the law firm Farella Braun + Martel: “It drives insurers crazy . . . . They’re paying settlements to the company. They were paid, for example, \$1 million in premiums and have to pay back a \$10 million derivative settlement to the company.”<sup>213</sup> One underwriter noted, “I’ve paid out on more A-side claims in recent years than in my prior 20 years combined.”<sup>214</sup> D&O insurance underwriters are taking action; as they see more ultra-large derivative suit settlements, they no longer regard Side A as “safe.”<sup>215</sup> Most significantly, underwriters have recently reported the company’s board as “the most important influence when it comes to mitigating D&O risk.”<sup>216</sup>

## B. Repercussions Of The Upward Trend In Derivative Suits

Formerly, most D&O insurance losses were from Side B or Side C.<sup>217</sup> However, as this new trend of derivative suits continues to rise, insurers recognize “notable settlements tapping ‘A-side only’ insurance.”<sup>218</sup> As a result, D&O premiums increased throughout 2019 and 2020.<sup>219</sup> As illustrated in the figure below, D&O insurance premiums’ “increase in price only began to notably accelerate at the beginning of 2019.”<sup>220</sup> Further, premium changes

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212. See Huskins, *supra* note 193 (explaining plaintiffs’ recoveries in securities class action lawsuits are highly correlated with the company’s public shares, market capitalization, and the size of the stock drop, while derivative claims have no clear and external factors to help determine a reasonable range of potential settlements prior to claims arising).

213. Contessa Brewer & Katie Young, *Companies Are Paying Big Bucks to Insure Boards Against Liability as Class-Action Suits Soar*, CNBC (Jan. 9, 2020), <https://www.cnbc.com/2020/01/09/companies-are-paying-big-bucks-to-insure-boards-against-liability-as-class-action-suits-soar.html> [<https://perma.cc/382S-65D7>].

214. WOODRUFF SAWYER, *supra* note 208, at 7.

215. *Id.* at 6.

216. *Id.* at 16.

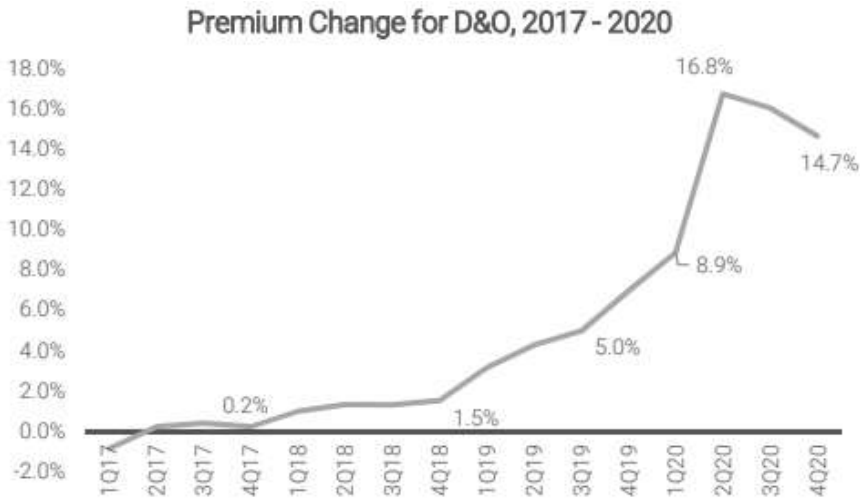
217. Baker & Griffith, *supra* note 166, at 1803.

218. WOODRUFF SAWYER, *supra* note 208, at 4.

219. *Id.*

220. COMMERCIAL PROPERTY/CASUALTY MARKET INDEX Q3/2020, THE COUNCIL (2020), <https://www.ciab.com/download/27365/> [<https://perma.cc/B6W4-3UST>].

in 2020 increased drastically from Q1 (8.9% increase in premiums) to Q2 and Q3 (16.8% and 16.1% respectively).<sup>221</sup> While there was a slight decrease in premium changes in Q4, underwriters do not see this as a hopeful prediction of what is to come.<sup>222</sup> Rather, experts suggest D&O premiums will continue to rise.<sup>223</sup>



Source: THE COUNCIL<sup>224</sup>

The below graph represents responses from a survey revealing that in 2020 alone, the average D&O rate increased for nearly all respondents, with 80% of respondents experiencing a rate increase of at least 10%.<sup>225</sup> Many companies are experiencing *significant* increases in D&O insurance premiums.<sup>226</sup> Markedly, 13% of respondents have seen an increase of 30–50%.<sup>227</sup> Other sources indicate D&O costs have quadrupled over the last two years for public companies.<sup>228</sup>

221. COMMERCIAL PROPERTY/CASUALTY MARKET INDEX Q4/2020, THE COUNCIL (2021), <https://www.ciab.com/download/28164/> [<https://perma.cc/S3BX-7TTU>].

222. *Id.*

223. *See id.*

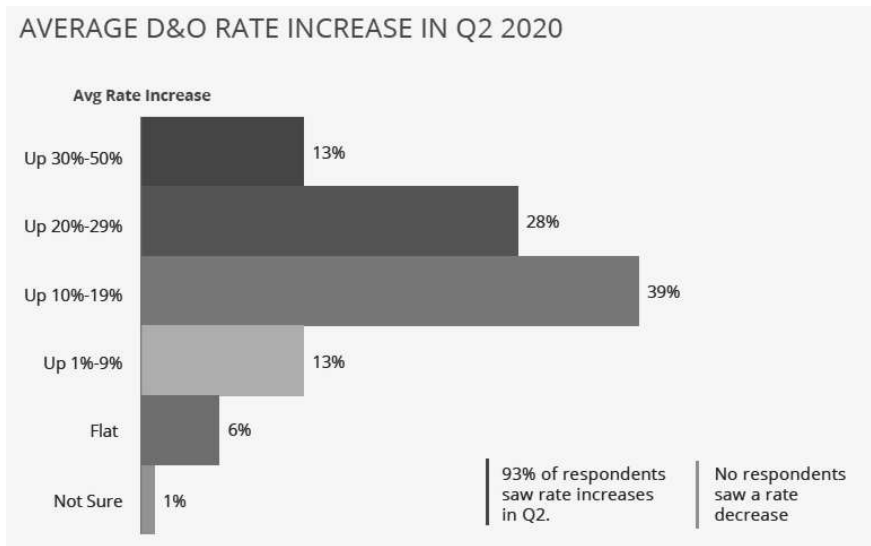
224. *Id.*

225. WOODRUFF SAWYER, *supra* note 208, at 9.

226. *See* COMMERCIAL PROPERTY/CASUALTY MARKET INDEX Q1/2021, THE COUNCIL (2021), <https://www.ciab.com/download/29767/> [<https://perma.cc/3642-DF9V>].

227. WOODRUFF SAWYER, *supra* note 208, at 9.

228. *See* Brewer & Young, *supra* note 213.



Source: WOODRUFF SAWYER<sup>229</sup>

Carriers are also cutting capacity in order to lower their risk exposure.<sup>230</sup> As underwriters recognize policies are underpriced, some carriers who would have previously provided \$10 million D&O policy for clients, are now only willing to provide \$5 million, and sometimes less.<sup>231</sup> Businesses will then need to look to substituting carriers in order to obtain the same level of protection.<sup>232</sup> However, knowing the original carriers believe the previous coverage premiums were underpriced, the substituting carrier will charge extra in order to insure the company at its previously insured level.<sup>233</sup>

Notably, this D&O market change has been seen before. In the 1980s there was a D&O insurance “crisis.”<sup>234</sup> After decades of expanding coverage and low premiums, the market for D&O insurance changed drastically—“premiums skyrocketed, deductibles increased, and coverage was reduced.”<sup>235</sup> Many argue that this “crisis” was caused mainly by the merger boom, the largest wave of acquisitions in history, which resulted in a substantial increase in shareholder lawsuits against directors.<sup>236</sup> These

229. WOODRUFF SAWYER, *supra* note 208, at 9.

230. *Id.* at 6.

231. *Id.*

232. *Id.*

233. *Id.*

234. Romano, *supra* note 189, at 1–2.

235. *Id.* at 1.

236. *Id.* at 13–15.

lawsuits were the result of shareholders objecting to the terms of acquisition deals, lack of disclosures, and attempts to prevent acquisitions.<sup>237</sup> As Professor Roberta Romano stated: “[t]his crisis threatened the board’s stability as a governance structure capable of protecting the shareholders’ interests. Since the board shapes the corporate decisionmaking [sic] environment, changes in [director and officer] liability may affect corporate behavior significantly.”<sup>238</sup> And the D&O market immediately affected corporate behavior: directors resigned when corporations’ insurance lapsed, while individuals declined invitations to serve on boards because firms lost D&O coverage.<sup>239</sup>

### C. The Pressure’s On

Derivative suits are the most threatening types of suits to insurance carriers because they are routinely not indemnifiable by the corporation, thus leading to large payouts by the insurer.<sup>240</sup> Experts suggest this trend will continue, as insurers experience more ultra-large derivative suits settlements.<sup>241</sup> Underwriters are responding to these trends: insurance carriers are managing exposure by cutting the limits they previously provided.<sup>242</sup> In 2020, underwriters reported that “a company’s board is the most important influence when it comes to mitigating D&O risk.”<sup>243</sup>

Looking at the underwriting process can provide an understanding of how D&O insurer underwriters quantify the board’s influence and risk. Underwriting is the process the insurer uses to determine the risks associated with insuring a company in deciding whether to offer coverage, what amounts of coverage, and the price of coverage.<sup>244</sup> In assessing risk, underwriters analyze two main areas: financial health and corporate governance.<sup>245</sup> In assessing financial health, underwriters look at things such as the maturity of the company, the industry, market capitalization, and accounting ratios.<sup>246</sup> The corporate governance analysis involves an

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237. *Id.* at 13–14.

238. Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1155 (1990).

239. Romano, *supra* note 189, at 1–2.

240. See WOODRUFF SAWYER, *supra* note 208, at 16.

241. *Id.*

242. *Id.* at 6.

243. *Id.* at 16.

244. Baker & Griffith, *supra* note 5, at 508.

245. *Id.* at 514–16.

246. *Id.* at 514–15.

underwriter assessing the “culture” and “character” of the insured.<sup>247</sup> Underwriters view culture and character as potentially even more important than financial health.<sup>248</sup> Culture reflects an investigation into structural features of the company like incentives, compensation, and compliance programs.<sup>249</sup> Character goes to the “ethics and confidence of the management of the company.”<sup>250</sup> Here, underwriters investigate the “reputation, skill set, and litigation history of each individual board member.”<sup>251</sup> Much of this information is obtained during “underwriters’ meetings,” which are private meetings where underwriters can request and gather private information not publicly available.<sup>252</sup> Further, since 1996, some D&O insurers keep a database which lists every director and officer who has ever been a defendant in a derivative suit.<sup>253</sup>

The recent wave in diversity derivative suits is not the only pressure companies are facing when it comes to improving DEI efforts. Institutional investors,<sup>254</sup> such as BlackRock and Vanguard, are making it clear to the companies they invest in that they expect the racial diversity of their boards to be disclosed and have used their proxy votes to drive this initiative.<sup>255</sup>

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247. *Id.* at 516–17.

248. *Id.* at 517.

249. *Id.* at 517–23.

250. *Id.* at 523.

251. *Id.* at 525.

252. *Id.* at 511–12. Because of the disclosure of private information during underwriters’ meetings, it is customary for underwriters to enter into nondisclosure agreements with insureds and potential insured. *Id.*

253. *Id.* at 513.

254. Institutional investors are companies or organizations that invest money on behalf of their clients or members. James Chen, *Institutional Investor*, INVESTOPEDIA (Nov. 22, 2021), <https://www.investopedia.com/terms/i/institutionalinvestor.asp> [<https://perma.cc/63SC-UELQ>]. Examples of institutional investors include hedge funds, mutual funds, and endowments. *Id.* These organizations are savvier than typical investors because they “have the resources and specialized knowledge for extensively researching a variety of investment opportunities not open to retail investors.” *Id.* They are the “big fish on Wall Street.” *Id.*

255. BlackRock asserts that it expects boards of directors of the companies in which it invests to “be comprised of a diverse selection of individuals.” BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: PROXY VOTING GUIDELINES FOR U.S. SECURITIES 6 (2020), <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> [<https://perma.cc/8WCM-GANF>]. This includes “consider[ing] the full breadth of diversity, including but not limited to the personal and professional factors . . .” such as “gender, ethnicity, race, and age, as well as . . . a director’s industry, area of expertise, and geographic location.” BLACKROCK, OUR APPROACH TO DIVERSITY 1–2 (2021), <https://www.blackrock.com/corporate/literature/publication/blk-commentary-engaging-on-diversity.pdf> [<https://perma.cc/L4DP-74TB>]; see also VANGUARD, INVESTMENT STEWARDSHIP: 2019 ANNUAL REPORT 1 (2019), [https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019\\_investment\\_stewardship\\_annual\\_report.pdf](https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019_investment_stewardship_annual_report.pdf) [<https://perma.cc/2U3M-2K98>] (noting its “board diversity expectations of public companies”).

There are also several lawmakers focusing on corporate diversity, at both the federal and state level. The “*Improving Corporate Governance Through Diversity Act of 2019*” was passed by the U.S. House of Representatives in November of 2019.<sup>256</sup> This bill requires issuers of securities to “disclose the racial, ethnic, and gender composition of their boards of directors and executive officers, as well as the status of any of those directors and officers as a veteran. It also requires the disclosure of any plan to promote racial, ethnic, and gender diversity among these groups.”<sup>257</sup> It further requires the Securities Exchange Commission (SEC) to create a Diversity Advisory Group in an effort to provide strategies to companies to increase gender, race, and ethnic diversity on their boards.<sup>258</sup>

The SEC took it a step further. On August 6, 2021, the SEC approved The Nasdaq Stock Market LLC (Nasdaq) proposals requiring mandatory reporting and disclosure of information about the diversity of boards of directors.<sup>259</sup> The newly adopted rule requires each Nasdaq listed company “to publicly disclose in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender and racial characteristics and LGBTQ+ status . . . of the company’s board of directors.”<sup>260</sup> The changes further require “at least two members of [a company’s] board of directors [to be] Diverse, including at least one director who self-identifies as female and at least one director who self-identifies as an Underrepresented Minority or LGBTQ+[,]” or the company will need to explain why it does not have such diversity requirements.<sup>261</sup>

At the state level, the country has watched as California took the lead on board diversity. In 2018, the state mandated that all public companies headquartered in California must have at least one woman on the board.<sup>262</sup>

256. Improving Corporate Governance Through Diversity Act, H.R. 5084, 116th Cong. (2019); see also *House Passes Bill to Increase Corporate Diversity*, U.S. HOUSE COMM. ON FIN. SERVS. (Nov. 19, 2019), <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=404822> [<https://perma.cc/JKT7-K7V6>] (noting the House of Representatives passed H.R. 5084).

257. *US HR5084*, BILL TRACK 50, <https://www.billtrack50.com/billdetail/1145126> [<https://perma.cc/Q6AM-3H68>] (last visited Aug. 29, 2021); see also H.R. 5084, 116th Cong. § 2 (2019) (requiring these disclosures).

258. H.R. 5084, 116th Cong. § 3 (2019).

259. U.S. SEC. & EXCH. COMM’N, SELF-REGULATORY ORGANIZATIONS, EXCHANGE ACT RELEASE NO. 34-92590 1 (2021), <https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf> [<https://perma.cc/B69F-LPPX>] (approving SR-NASDAQ-2020-081 and SR-NASDAQ-2020-082).

260. *Id.* at 3–4.

261. *Id.* at 4.

262. See Jessica Gynn, *New California Law, the First of Its Kind, Requires Racial Diversity on Corporate Boards of Directors*, USA TODAY (Oct. 5, 2020), <https://www.usatoday.com/story/money/2020/09/30/california-law-requires-racial-diversity-corporate-boards/5874469002> [<https://perma.cc/8VRA-5U8D>]; see also Michal Lev-Ram, *Exclusive: California’s Board Diversity Law Led to 670 Board Seats Filled by Women, Report*

Most recently, the Governor signed a similar mandate requiring that by the end of 2021, those companies must also have a minimum of one director from an underrepresented group.<sup>263</sup>

As stakeholder demands for accountability to DEIJ efforts continue to rise and diversity requirements are codified into law, more avenues for shareholder litigation will be created. Shareholders will have an easier time overcoming the hurdles of derivative suits. With the elevated litigation frequency and increasing severity contributed to carrier losses, D&O insurance premiums will continue to rise, coverage limits will continue to decrease, and more companies will be denied coverage and renewals.

## CONCLUSION

Social movements are made to create change. The world witnessed the BLM movement change not only the public's opinion, but corporate America's. As stakeholders embodied the need for diversity, companies committed to DEIJ initiatives. However, many companies have failed to follow through with those commitments and are realizing the consequences through diversity driven derivative suits. As legislators, regulators, investors, and industry leaders push for accountability, the trend in derivative suits shows no evidence of slowing down.<sup>264</sup> Consequently, even the best-intentioned board or officer faces a heightened environment of potential liability if they cannot show evidence supporting DEIJ initiatives. D&O insurers are in the position to pressure boards and officers to be accountable for their DEIJ initiatives, for if they fail to do so, underwriters will continue to raise premiums, limit coverage, and ultimately deny coverage—exposing directors and officers to personal risk. By taking tangible actions towards DEIJ initiatives, not only will boards and officers limit their liability, but they will also play a role in improving society.

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*Finds*, FORTUNE (Oct. 13, 2020), <https://fortune.com/2020/10/13/california-boards-diversity-jennifer-siebel-newsom/> [<https://perma.cc/6Q5T-Z7GN>] (examining the 2018 law).

263. Patrick McGreevy, *Newsom Signs Law Mandating More Diversity in California Corporate Boardrooms*, L.A. TIMES (Sept. 30, 2020), <https://www.latimes.com/california/story/2020-09-30/california-law-requires-diversity-corporate-boardrooms-gavin-newsom> [<https://perma.cc/UN7A-XY2W>].

264. See WOODRUFF SAWYER, *supra* note 208, at 19 (“[W]e are starting to see shareholders file breach of fiduciary duty suits against the boards of major corporations for failing to live up to their diversity commitment disclosures. Expect to see more of these in 2021.”).