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Breaches in the boardroom: What directors and officers can do to reduce the risk of personal liability for data security breaches

Gerard M. Stegmaier

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Brenda R. Sharton, Partner and Gerard M. Stegmaier, Partner; Goodwin Procter

Corporate directors and officers may increasingly be targets of shareholder derivative lawsuits in the wake of the surge of regulatory actions and private litigation around data breaches. While no individual directors and officers have been held liable for the costs of a data breach to date, such lawsuits have been filed. Signals from plaintiffs' attorneys indicate that, if they have their way, the wave will break soon. Corporate leaders need not be caught off guard. As a recent court decision confirms, the risk of individual liability can be mitigated by taking proactive measures.

Data breaches on the rise

2014 was hailed as yet another year of the data breach. A recent study by the Ponemon Institute estimates that 43% of companies experienced a data breach last year, led by high-profile incidents at Target, eBay, Adobe, Snapchat, Michaels, Home Depot, Neiman Marcus and AOL. And, of course, 2014 was capped off by the breach of Sony Pictures Entertainment, which splashed celebrity gossip and entertainment industry chatter across the headlines, as well as business-critical, confidential information regarding company financials and projections and employees' personal information.

Personal liability for directors and officers – *Caremark* is alive and well

A shareholder derivative action is a lawsuit brought by a corporation's shareholders, ostensibly on behalf of the corporation, and often against the corporation's directors and officers. In its 1996 *Caremark* decision, the Delaware Chancery Court declared that, in such actions, directors can be held personally liable for failing to "appropriately monitor and supervise the enterprise." The court emphasized that a company's board of directors must make a good faith effort to implement an adequate corporate information and reporting system. Failing to do so can constitute an "unconsidered failure of the board to act in circumstances in which due attention would, arguably, have prevented the loss."

The *Caremark* case has become a beacon across the corporate world for director conduct and now covers officers, including general counsel. Directors and officers must not demonstrate a "conscious disregard" for their duties or ignore "red flags" – failure to do so can result in a director or officer being held personally liable for a corporation's losses. This is because, as the Delaware Supreme Court later clarified in *Stone v. Ritter*, conduct that evidences a lack of good faith may violate the fiduciary duty of loyalty. And, although Delaware law allows a corporation to waive or limit a director's liability for violations of the duty of care, such waivers or limits are not

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