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#MeToo and the Emerging D&O Risks

The #MeToo movement has spawned a new era for corporate America with regard to how we look at and what we do in response to allegations of sexual harassment. It has forced corporate America to give serious consideration to the manner in which to consider and manage the risks stemming from sexual harassment by corporate officers and directors.

While complaints of sexual harassment at work are not new, the revelation that the head of a film studio not only was permitted to pursue a decades-long career as a sexual predator but also, in fact, was enabled by corporate leadership to engage in such behavior has been met with a collective sense of horror. The practice of journalistic “catch and kill” to bury claims of sexual misconduct and grossly inappropriate behavior has drawn scrutiny, as well. And the spotlight is shining starkly on the manner in which corporations have placed a premium on “managing” the immediate financial risk presented by the claims and fallout from the allegations, and insulating individuals perceived to be key performers, rather than placing the focus on refusing to tolerate and taking aggressive action toward eradicating such behavior. All of this has revealed a corrosive culture that society at large now seems unwilling to tolerate.

Previously, ugly allegations might have been addressed quietly, settlement agreements might have been drawn up, and the individuals accused of such conduct might have been permitted to proceed in their leadership positions as if nothing had happened—with the excuse being that the individual’s value to the company justified dealing with the allegations in this manner. However, the discovery of the depth of the ugliness that has been concealed and enabled has had a dynamic impact, the reverberations from which are only just beginning to be felt.

In reaction to the veil being lifted, investors are now suing companies and their boards for the manner in which they have handled allegations of sexual harassment by corporate leadership and for the impact that their conduct may have on the company’s bottom line due to perceptions that it enabled such behavior. This means bringing suit under the antifraud provisions of the Securities Exchange Act of 1934, as well as shareholder derivative suits for breach of fiduciary duties owed to the shareholders by

corporate boards of directors when the news of the sexual harassment comes out and the stock price of the company suffers a hit and/or the brand is tarnished.

How do companies and their boards deal with this new paradigm? How do they identify the risks and take the necessary steps to protect against them? This article will provide an overview of the new landscape to be navigated, discuss the issues presented, and offer a road map for how to deal with these issues going forward.

I. Rise in Sexual Harassment Allegations

For years, companies and their boards were able to quietly settle and then sweep under the rug sexual harassment allegations as there was little financial incentive to address them in a more fulsome manner.ⁱ Times have changed. While a company's stock price may not be impacted when allegations of sexual harassment first surface,ⁱⁱ a company has to consider the possibility that a serious financial risk can occur when a company does not deal with claims promptly, directly, and in a manner that evidences a corporate culture intolerant of such behavior.

An illustrative example can be seen in what happened when model Kate Upton accused the Guess cofounder of sexual harassment: shortly thereafter, the company's shares dropped nearly 18 percent, shedding roughly \$250 million in value.ⁱⁱⁱ As another example, Twenty-First Century Fox paid out an eight-digit settlement in 2016 for its mishandling of sexual harassment claims against Roger Ailes and Bill O'Reilly.^{iv} Still another cautionary tale is told in how the market reacted to the lawsuits against Steve Wynn, Wynn Resorts, and his board of directors concerning Wynn's alleged decades-long sexual misconduct.^v In the aftermath of these suits, the stock price of Wynn Resorts dipped nearly 20 percent.^{vi} And the most telling example is that of the Weinstein Company: an entire brand has been eviscerated by the revelations of Weinstein's enduring sexual misconduct and the failures of the Weinstein board to take effective measures to put a stop to it.^{vii}

II. The Securities Exchange Act of 1934

The Securities Exchange Act of 1934 (Exchange Act) regulates the secondary trading of securities and, under its antifraud provisions, makes it

unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange[,] . . . [t]o use or employ . . . any manipulative or deceptive device or contrivance [in selling securities].^{viii}

The purpose of the Act is to create a mandatory disclosure process designed to force companies to make public information that investors would find pertinent in making investment decisions, and to provide a means of punishing individuals and companies

that either make false or misleading statements about the company or make use of information not available to the public to enrich themselves at the expense of other investors.

A plaintiff may bring an action against a public company for violations of the antifraud provisions of the Exchange Act via the private right of action authorized pursuant to sections 10(b) and 20(a) of the Exchange Act. The claims brought under the Exchange Act arising from how a corporation has addressed complaints of sexual harassment generally have centered on a company's duty to disclose and report the claims and risks presented thereby in its public filings made to the Securities and Exchange Commission (SEC), such as the annual 10-K and quarterly 10-Q filings.

Under Rule 10b-5, it is unlawful for a public corporation to make any untrue statements or omissions of a "material fact" that would render any statement made to the SEC "misleading."^{xix} Under Item 103 of Regulation S-K of the Securities Act of 1933, a public corporation also has an affirmative duty to disclose "any material legal proceedings" that are pending against it before a court or agency, as well as "any proceedings known to be contemplated by governmental authorities."^{xx} Additionally, under Item 303 of Regulation S-K, a company must disclose any

known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.^{xi}

The U.S. Court of Appeals for the Second Circuit has held that a company is required to disclose statements from Item 303 pursuant to section 10(b) filings.^{xii}

III. The Fiduciary Duty Owed to Shareholders by Officers and Directors

Every officer and director of a company owes its company and shareholders fiduciary duties of care and loyalty, which, if violated, can subject them to a derivative action.^{xiii} A shareholder who brings a derivative action must either make a demand on the directors to bring a litigation or set forth particularized factual allegations in a complaint that such demand on the board would be futile by raising a reasonable doubt that either (1) the directors are disinterested and independent or (2) the board's decision was not a valid exercise of business judgment.^{xiv}

In the context of sexual harassment, officers and directors can breach their duties by sexually harassing employees (and, in so doing, intentionally act with a purpose other than that of advancing the best interests of the corporation) or failing to monitor or investigate known sexual harassment claims.^{xv}

IV. Sexual Harassment and the Risks Presented

The Equal Employment Opportunity Commission defines *sexual harassment* as “unwelcome sexual advances, requests for sexual favors, and other verbal or physical harassment of a sexual nature.”^{xvi} It is defined similarly in many state and city statutes.^{xvii} Sexual harassment does not have to be of a sexual nature for it to be unlawful; sexual harassment also extends to offensive comments about a person’s gender.^{xviii}

Until recently, sexual harassment claims were largely risk specific to the claimant, manageable through employment practices liability insurance (EPLI) coverage, and not likely to present a potential for risk in the form of securities fraud and/or shareholder derivative litigation. However, there have been a number of claims of recent vintage that should put every corporate leader on notice that these types of claims, and how they are handled, can pose such risks today—and in a very substantial way. These claims have been largely premised on two theories of liability: (1) violations of the Exchange Act and (2) breach of fiduciary duty claims.

V. #MeToo: Securities Fraud and Shareholder Derivative Suits

The private right of action under section 10(b) can be implicated in the sexual harassment context when a company makes statements to the SEC concerning its board’s integrity; success; or any ongoing investigations, which is the basis for one of the current suits against Steve Wynn, Wynn Resorts, and its various officers.^{xix} In the class action that was brought in that matter, investors alleged violations of sections 10(b) and 20(a) based on the board’s alleged failure to disclose the CEO’s “pattern of sexual misconduct” in light of the alleged false statements that it previously made to the SEC that any reported violations of the company’s “code of business conduct” would be “taken seriously and promptly investigated.”^{xx} The plaintiffs alleged that the company was under a duty to disclose the alleged “decades-long pattern of sexual misconduct” by Wynn, which has since been made public, and the ensuing arbitration against the company and its CEO.^{xxi}

Similarly, last year, shareholders sued Signet Jewelers, which sells jewelry through Kay Jewelers and Zales, and its CEO, Mark Light, for violations of the antifraud provisions of sections 10(b) and 20(a) of the Exchange Act.^{xxii} The lawsuit in that case alleged that the company failed to disclose a nearly decade-old arbitration involving claims by approximately 69,000 female employees who had alleged a corporate culture of sexual harassment and discrimination that included a number of executives, including Light.^{xxiii} The plaintiffs alleged violations of section 10(b) and Rule 10b-5 as a result of, among other things, the board’s failure to properly disclose the harassment and the board’s misleading statements and omissions “that caused the price of Signet common stock to be artificially inflated during the Class Period.”^{xxiv} A month before the plaintiffs filed their complaint, the *Washington Post* published an article detailing the sexual harassment claims.^{xxv} While Light is not nearly as synonymous with the Signet brand as Harvey Weinstein is with the Weinstein Company or Steve Wynn is with Wynn Resorts, the Signet brand name was damaged by the news of the sexual harassment claims and Light’s alleged participation in activity by “top male managers,” including

dispatch[ing] scouting parties to stores to find female employees they wanted to sleep with, laugh[ing] about women's bodies in the workplace, and push[ing] female subordinates into sex by pledging better jobs, higher pay or protection from punishment.^{xxvi}

Plaintiffs alleged that these actions caused the company's stock to fall nearly 13 percent and its common stock price to fall 58 percent from its class period high.^{xxvii}

An example of an application of a derivative action arising from sexual harassment claims can also be found in the suit filed by the shareholders of Wynn Resorts, which alleged that the board and its CEO breached their fiduciary duties by failing to effectively exercise oversight over Wynn Resorts and its CEO by "failing to police, investigate and act . . . to address the known credible allegations of intentional egregious misconduct and violations of law by Steve Wynn involving Wynn Resorts."^{xxviii} The derivative complaint details the board's alleged knowledge of decades-long sexual harassment by Wynn (which allegedly included, on numerous occasions, instructing a massage therapist employed at Wynn's Las Vegas spa to touch his genitals), including the board's specific knowledge of an alleged rape by Wynn—specifically brought to the board's attention by Wynn's ex-wife—that culminated in a \$7.5 million settlement paid to the victim.^{xxix} Wynn resigned as CEO shortly after the *Wall Street Journal* published an article about his alleged rampant sexual misconduct.^{xxx}

Similarly, in 2016, stockholders of Twenty-First Century Fox alleged that their board of directors failed to properly exercise oversight over Fox's workplace and thereby permitted a hostile workplace plagued by "rampant sexual harassment and exploitation," including sexual harassment by Ailes for at least a decade.^{xxxi} With damage claims based on, among other things, the payment of tens of millions of dollars to settle Bill O'Reilly's alleged sexual harassment, a drop in advertising revenue and ratings, and the "loss of high profile talent," Fox quickly settled the claims for \$90 million.^{xxxii}

A. Obstacles in a derivative action.

While it is fairly straightforward to argue that a director or officer will have breached his/her fiduciary duties to the shareholders by personally engaging in sexual harassment of the company's employees and/or participating in and fostering a culture of sexual harassment and discrimination, it can be challenging for a derivative plaintiff to maintain a breach of fiduciary duty claim for a failure to monitor and exercise oversight, which is referred to as a *Caremark* claim.^{xxxiii}

In order to allege a breach under *Caremark*, a plaintiff must meet the high burden of showing a "sustained or systemic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system."^{xxxiv} To do this, plaintiffs must show that

(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, [they] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.^{xxxv}

Directors may be liable under a *Caremark* theory where “red flags” are “waived in one’s face or displayed so that they are visible to the careful observer.”^{xxxvi} Because sexual harassment often involves surreptitious conduct, this can make a breach of fiduciary duty claim for failure to monitor and exercise oversight challenging. Nonetheless, where evidence of a systemic failure by the board to address a pattern of sexual harassment involving various red flags of misconduct that the board fails to address can be shown, such a claim may have legs.

In the past, plaintiffs were unsuccessful in efforts to pursue shareholder derivative suits arising out of alleged sexual harassment based on a *Caremark* theory of liability.^{xxxvii} As a relatively recent example, shareholders of American Apparel brought suit against the company, several directors, and the CEO in 2010 and then again in 2014, alleging that the board breached its fiduciary duties with regard to the CEO’s sexual harassment.^{xxxviii} A California district court dismissed the 2010 complaint, holding that bare allegations of the CEO’s sexual tendencies could not meet the high threshold imposed by *Caremark*.^{xxxix} As more sexual harassment allegations arose, shareholders of American Apparel brought suit again in 2014.^{xl} Yet again, however, the court concluded that plaintiffs had failed to show that the American Apparel Board demonstrated a conscious disregard for its responsibilities when it “eventually did investigate, then suspended, and ultimately terminated [the CEO].”^{xli}

B. The changing landscape.

This challenging past history notwithstanding, it appears that the tide may be about to turn. Allegations involving a lengthy history of sexual harassment over many years, knowledge by the corporate boards of directors of their companies of this conduct, and conduct arguably designed as much to conceal and enable the harassing behavior as to provide recompense to the victims and avoid negative publicity could prove to be sufficient to meet this standard.

For instance, in *DiNapoli v. Wynn*, the New York State comptroller’s office and several pension funds filed a derivative suit against Steve Wynn and Wynn Resorts’ board of directors and officers, alleging that the board breached its fiduciary duties

based on a decades-long pattern of sexual abuse and harassment by Steve Wynn that remained unchecked, tacitly permitted, and eventually covered up by Defendants, resulting in a breach of their duty of loyalty and other fiduciary duties to stockholders.^{xlii}

The plaintiffs in this case tracked the language of a *Caremark* theory in their amended complaint, filed on March 23, 2018, alleging that the board failed to act “in the face of known and credible allegations.”^{xliii} In addition, the board

intentionally and knowingly breached their fiduciary duties by *failing to implement internal controls that would alert them* to the hostile work environment created by Steve Wynn’s widespread sexual harassment and abuse, which was repeatedly reported to senior Company Officials

since at least 2005, and concealed his sexual misconduct from the stockholders by repeatedly misrepresenting the company’s corporate governance framework.^{xliv} Based on these allegations, it appears that the plaintiffs may have enough to meet the *Caremark* standard.^{xlv}

Similarly, in *Asbestos Workers’ Philadelphia Pension Fund v. Hewitt*, a pension fund filed a derivative class action against several directors and officers of Liberty Tax and its CEO, John Hewitt, stemming from Hewitt’s alleged widespread sexual harassment that was claimed to have irreparably damaged the company and caused it to pay out settlements and enter into unfair transactions.^{xlvi} In the complaint, plaintiffs allege that Hewitt breached his fiduciary duty by not only engaging in inappropriate sexual activity in the workplace and using company resources for his own “sexual gain” but also, after being fired for such conduct in September 2017,

disloyally wield[ing] corporate governance powers as Liberty’s controlling stockholder and Chairman of the Board to, in effect, vacate the Board’s decision, reestablish himself as the de facto sole power at the Company and make it intolerable for anyone but the most loyal to serve on the Board or in senior management.^{xlvii}

While the complaint against Liberty Tax did not track the language of a *Caremark* claim or explicitly allege a failure to monitor or oversee claim against the board of directors (most likely because the board fired Hewitt after an independent investigation two months prior), the plaintiffs did allege that several of the Hewitt-loyal individual directors breached their fiduciary duties b(1) by rendering the corporate governance of the company “so dysfunctional that independent directors were unable to exercise their own respective fiduciary duties, causing them to resign,” and (2) by terminating the independent director recruitment process.^{xlviii}

C. Recent/Upcoming Legislation

In reaction to the spate of revelations of sexual harassment by senior corporate officers and directors over many years, a variety of legislation has been proposed or

passed with the objective of making it more difficult to conceal such conduct. This has taken place on both the state and federal level.

For example, on December 22, 2017, Congress passed the Tax Cuts and Jobs Act, which includes an amendment that focuses exclusively on a company's sexual harassment claims. The amendment, entitled "Payments related to sexual harassment and sexual abuse," provides thus:

No deduction shall be allowed under this chapter for—

- (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or
- (2) attorney's fees related to such a settlement or payment.^{xlix}

This amendment theoretically could have far-reaching financial implications for companies going forward because most settlements for sexual harassment claims are accompanied by a nondisclosure agreement.

However, recent state legislation on the use of nondisclosure agreements actually may curb the impact of this amendment on a company. As of April 5, 2018, the New York legislature passed a bill that prohibits employers from including a nondisclosure agreement in any settlement of a sexual harassment claim unless the complainant is the party to request it.^l In addition, this legislation will prohibit employers from requiring employees to contractually agree to arbitrate sexual harassment claims.^{li} New York Governor Andrew Cuomo signed the legislation into law on April 12, 2018.^{lii} New Jersey and California also are contemplating similar legislation regarding nondisclosure agreements.^{liii}

Moreover, California lawmakers have proposed legislation to extend the statute of limitations for employment-related sexual harassment claims under California's Fair Employment and Housing Act from one year from the date upon which the unlawful practice occurred to three years.^{liv} Several other states are considering similar legislation to extend the statute of limitations for plaintiffs to file a civil suit or for district attorneys to prosecute related cases, including Massachusetts, Michigan, Missouri, New York, Vermont, Washington, and Wisconsin.^{lv}

While we have yet to see what financial impact any of this legislation will have on companies, it is sure to put a company more at risk and change the way that it addresses allegations, as negotiated resolution of sexual harassment claims will be more and more difficult going forward to keep secret, and the time frames within which such claims can be brought is likely to be broadly expanded.

VI. Managing/Mitigating the Risk

A. D&O, EPLI, and related coverage.

Traditionally, companies have sought to manage the risks presented by the potential for sexual harassment by officers and directors principally through the purchase of employment practices liability insurance (EPLI) and directors and officers (D&O) policies, which include EPL coverage. These policies, however, have limits to their coverage.

As EPLI coverage is intended to cover claims brought by employees, standard EPLI policies may not extend to claims brought by third parties.^{lvi} Most D&O and EPLI policies also exclude coverage for claims of bodily injury, which means that an insurer will not cover claims for any type of touching, rape, assault, or battery. Additionally, both EPLI and D&O policies may have various exclusions, including an exclusion for criminal acts, fraud, and dishonesty. On the other hand, emotional distress and anguish associated with any bodily injury may be covered under an EPLI policy, and stand-alone policies such as sexual abuse and molestation policies are available to protect management, employees, and the entity against allegations of abuse, molestation, or mistreatment of a sexual nature. Further, the exclusion for fraud and dishonesty typically requires final adjudication to apply.

It also should be noted that D&O insurance is intended to cover claims for the “wrongful acts” of a company’s directors and officers, but only if the director or officer was acting within the course and scope of his/her employment when committing the act. Accordingly, a gap in coverage may occur if the director/officer committed the wrongful act outside the scope of employment.^{lvii} D&O policies also typically contain an “insured versus insured” exclusion, which may operate to preclude coverage for claims made by an employee deemed an *insured person* under the policy terms against an executive and/or the company insured under the policy. And while damage to the company’s reputation from the disclosure of either claims of sexual harassment by senior corporate management or a culture that encourages or ignores rampant sexually harassing behavior may pose perhaps the biggest financial risk to the company, D&O policies may not afford coverage for the cost of retaining a public relations firm to respond to the situation.^{lviii}

Another issue to be aware of is that D&O and EPLI policies provide claims-made coverage and thus provide coverage for claims made against a policyholder only during a specified period. Claims-made policies generally require that a policyholder timely report any claim made against it to the insurer, which may be a period of thirty days. Accordingly, gaps in coverage may arise when a company fails to report promptly a sexual harassment claim to an insurer or assumes that a previous or future claim is covered by its policy.

Gaps in coverage can also arise through a prior acts or prior litigation exclusion, which excludes coverage for claims involving facts or occurrences that either were the subject of prior litigation or commenced before the start of coverage.^{lix} Under this exclusion, an insurer can deny coverage where there are common facts between the prior

claim and the current claim. If, for example, a company receives a books and records demand that includes certain allegations of potential wrongdoing, an insurer could potentially deem that demand a prior or pending litigation for purposes of the exclusion.

Moreover, companies should be aware of the aggregate limit of liability and per-claim deductibles in their policies' terms. Specifically, claims that arise out of the same or related events are treated as a single claim starting from the earliest date that the claim is reported.^{lx} As such, separate lawsuits, related class action complaints, and suits filed by multiple plaintiffs may be deemed to create a single claim subject to a single maximum limit of liability and only one claims-made policy.^{lxi} This will have an impact in the sexual harassment context when plaintiffs file various complaints stemming from the same wrongs, the same pattern of sexual harassment, and the same breaches of fiduciary duty—as evidenced by the various suits filed against Wynn and the directors and officers of Wynn Resorts.

Insurers can also refuse coverage when a policyholder previously made misrepresentations on its policy application. For instance, in *Zion Christian Church v. Brotherhood Mutual Insurance Co.*, the U.S. Court of Appeals for the Sixth Circuit found that an insurer could reject coverage where the insured made several misrepresentations on its application by concealing past sexual conduct.^{lxii} Similarly, a federal judge rescinded two D&O policies because the company failed to disclose past sexual harassment claims against its CEO on its policy applications.^{lxiii} When filing applications, companies must confirm the accuracy of all statements made in applications or risk a lapse in coverage.^{lxiv}

B. SEC reporting duties.

As the Weinstein and Wynn cases evidence, an important part of risk management is being conscious of a possible need to report sexual harassment claims on the company's public filings. It is abundantly clear that such claims can have a material impact on the firm's business and stock price, so it no longer will be valid to assume that settlements of such claims have fully addressed the pertinent issues.

C. Employment policies and sexual harassment claims.

Lastly, there needs to be a renewed focus on monitoring and enforcing the

company’s sexual harassment policies. While insurance may cover the financial costs of a suit and any resulting settlement, the revelations emerging as a result of the #MeToo movement should cause boards to be warier of what might be lurking quietly beneath the surface. There is naturally a presumption that the individuals you entrust with the management and operations of your business are going to comport themselves appropriately, but “assuming the best” is not a viable risk-management policy—certainly not in the times that we now live in. Furthermore, it is dangerous to assume that just because the company has written policies in place, employees are fully aware of their rights and feel safe and comfortable reporting sexual harassment.

VII. CONCLUSION

Even in the current climate, it is still unlikely that there will be successful securities fraud actions based on alleged misrepresentations stemming from a corporation’s aspirational statements regarding (1) a refusal as a matter of policy to tolerate harassment or (2) a practice of consistently promoting a culture committed to honest and ethical conduct. But if a complaint sets forth specific allegations of abhorrent ongoing conduct by senior management and/or a widespread toxic culture, there is a much greater likelihood that the complaint will survive a motion to dismiss. Indeed, the most likely basis for a successful securities fraud or shareholder derivative action is allegations of knowledge of ongoing and continuing sexual harassment and other sexual misconduct—which potentially expose the corporation to significant liability and have the capacity to do substantial damage to the corporate brand—coupled with efforts to insulate particular officers and directors from the consequences of such conduct and conceal such conduct via confidential settlements.

While one might think that these types of circumstances are rare, the fact of the matter is that the #MeToo movement has lifted what was previously a very large and protective boulder and, in the process, has given the world a peek at some very ugly things crawling around underneath. As such, it can be reasonably anticipated that claims of this sort are more likely to grow in the short term, particularly in the realm of the shareholder derivative suit against the small to midsize privately held corporation dominated by an individual around whose entrepreneurial aptitude the company has been built.

Corporate awareness of the risk presented by this behavior and the implementation of systemic processes to meet the risk is critical so that the lessons currently being taught by the #MeToo movement quickly become lessons *learned*. In order to address this developing risk, professors Daniel Hemel and Dorothy Lund offer a useful list of suggestions for boards to consider going forward in an effort to both avoid the risk altogether and attempt to manage it as claims may arise:

- Take stock of their companies’ past responses to sexual harassment claims and, in so doing, identify repeat offenders so that they can be weeded out.^{lxv}
- Review their companies’ procedures for handling complaints, and take steps to ensure that employees are fully aware of and feel comfortable reporting misconduct.^{lxvi}

- Ensure that policies providing for “meaningful consequences” for harassers are in place (including empowering managers to impose sanctions ranging from reprimands to bonus reductions to termination for repeat offenders).^{lxvii}
- When confronted with allegations of sexual harassment by corporate officers or widespread harassment throughout the company, hire outside counsel to conduct a thorough investigation of the claims.^{lxviii}
- Approve the use of corporate funds to pay liability- and litigation-related expenses only in those instances where an internal investigation has been undertaken and it has been concluded that those claims are unfounded.^{lxix}
- Accept that even in cases where the target of the allegations is a CEO who is associated with the company’s brand, there is misconduct that rises to the level of a fireable offense, and that “[t]he damage to a firm’s value from losing an iconic CEO may be far less than the reputational consequences of a high-profile sexual harassment scandal.”^{lxx}
- Consider whether statements in their SEC filings might be misleading if sexual misconduct claims emerge.^{lxxi}

Additionally, boards need to consider carefully the insurance coverages in place, what is and is not likely to be covered, and the issues that potentially may arise in regard to insurance claims:

- Analyze the company’s D&O and EPLI insurance to make sure that it provides the levels of coverage necessary to meet the risks presented. This includes careful consideration of per-claim deductibles and aggregate limits.
- Take stock of the complaints that have been resolved via settlement and whether the continued employment of particular repeat-offender directors and officers, because of the new dynamic, may present much greater exposure to financial risk than previously anticipated.
- Make sure that knowledge and awareness of claims have been fully vetted at the time of the policy application.
- Consider the purchase of coverage for retention of a public relations firm to handle crisis management.

As Ben Franklin famously stated, “By failing to prepare, you are preparing to fail.” For corporate boards, the #MeToo movement is a call to action—and none too soon.

Notes

ⁱ. An excellent discussion of some of these cases can be found in Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, COLUM. L. REV. (forthcoming 2018).

ii. See Ryan Vlastelica, *Why the Wave of Sexual Harassment Allegations Won't Have an Impact on Stock Prices*, MARKETWATCH (Dec. 15, 2017), www.marketwatch.com/story/why-the-wave-of-sexual-harassment-allegations-wont-have-an-impact-on-stock-prices-2017-12-15.

iii. See Samantha Cooney, *Companies Are Losing Millions After #MeToo Allegations Like Kate Upton's Claim Against Guess' Paul Marciano*, TIME (Feb. 2, 2018), <http://time.com/5130340/kate-upton-guess-stock-price>.

iv. See Jonathan Stempel, *21st Century Fox in \$90 Million Settlement Tied to Sexual Harassment Scandal*, REUTERS (Nov. 20, 2017), www.reuters.com/article/us-fox-settlement/21st-century-fox-in-90-million-settlement-tied-to-sexual-harassment-scandal-idUSKBN1DK2NI.

v. See Complaint, *Ferris v. Wynn Resorts Ltd.*, No. 18-cv-01549, 2018 WL 1023165 (S.D.N.Y. Feb. 20, 2018); Complaint, *Norfolk Cnty. Ret. Sys. v. Wynn*, No. A-18-769062-B, 2018 WL 770483 (Nev. Dist. Ct., Clark Cnty. Feb. 6, 2018).

vi. See *Ferris*, 2018 WL 1023165; *Norfolk Cnty. Ret. Sys.*, 2018 WL 770483.

vii. Recent developments indicate that the trend evidenced by these cases is just getting started and that a number of similar claims will be brought going forward. For example, while this article was originally being readied for print, a federal securities class action complaint, *Danker v. Papa John's International, Inc.*, was filed in the U.S. District Court for the Southern District of New York. Case No. 1:18-cv-07927 (S.D.N.Y. Aug. 30, 2018). The suit alleges that throughout the class period – alleged to run from February 25, 2014, through July 19, 2018, when an article was published in *Forbes* magazine entitled “The Inside Story of Papa John’s Toxic Culture” and Papa John’s stock price fell \$2.60 per share – defendants (including Papa John’s International, Inc. (Papa John’s) and John H. Schnatter (Schnatter), the company’s founder) made materially false and misleading statements regarding Papa John’s business, operational, and compliance policies:

“Papa John’s executives, including Defendant Schnatter, (i) had engaged in a pattern of sexual harassment and other inappropriate workplace conduct at the Company; (ii) Papa John’s Code of Ethics and Business Conduct was inadequate to prevent the foregoing misconduct; (iii) the foregoing conduct would foreseeably have a negative impact on Papa John’s business and operations, and expose Papa John’s to reputational harm, heightened regulatory scrutiny, and legal liability; and (iv) as a result, Papa John’s public statements were materially false and misleading at all relevant times.”

Id. ¶ 4. Asserting claims for violation of sections 10(b) and 20(a) of the Exchange Act, plaintiffs allege that Papa John’s filed 10-Ks each year during the class period that failed to disclose that Schnatter had spied on workers and engaged in sexually inappropriate conduct, which resulted in at least two confidential settlements. *Id.* ¶ 47. Another recent suit is *Luczak v. National Beverage Corp.*, pending in the U.S. District Court for the Southern District of Florida. (No. 0:18-cv-61631-KMM, 2018 WL 3467900 (S.D. Fla. July 17, 2018)). The suit involves claims brought under the Exchange Act based on violations of sections 10(b) and 20(a) against the company that owns La Croix, National Beverage Corp., and its chief executive officer and executive vice president. The complaint alleges that the defendants failed to disclose that its CEO engaged in a pattern of sexual misconduct between 2014 and 2016 despite stating that it “absolutely prohibited” sexual harassment and actively enforced its anti-harassment policy. See Amended Complaint, *Luczak v. National Beverage Corp.*, No. 0:18-cv-61631-KMM, ¶¶ 69-77 (S.D. Fla. Nov. 2, 2018). The complaint goes on to allege that, in July 2018, the *Wall Street Journal* reported the CEO’s sexual misconduct in an article detailing that two pilots had previously filed lawsuits alleging that National Beverage’s CEO “engaged in repeated unjustified, unwarranted and uninvited grabbing, rubbing and groping of [plaintiff’s] leg in a sexual manner, reaching up towards [plaintiff’s] sexual organs.” *Id.* at ¶ 14.

Following the recent allegations of sexual harassment by Les Moonves, detailed in an August 2018 *New Yorker* article by Ronan Farrow entitled *Les Moonves and CBS Face Allegations of Sexual Misconduct*, *New Yorker*, Aug. 8, 2018, a securities class action lawsuit was filed against CBS on August 27, 2018 in U.S. District Court entitled *Lantz v. CBS Corporation*, Case No. 18-cv-08978. As succinctly described in a law firm press release regarding the claims, “[t]he complaint alleges that throughout the Class Period [set as November 3, 2017 – July 27, 2018], [CBS and certain of its officers and directors] made materially false and misleading statements and/or failed to disclose adverse information regarding CBS’s business and operations. Specifically, the complaint alleges the defendants failed to disclose that CBS’s business

operations were facing substantial risk as CBS was being drawn further into conflict with the #MeToo movement as a result of the ongoing media investigations into prior allegations of misconduct by CBS's CEO, Leslie Moonves, and that having CBS drawn further into conflict with the #MeToo movement subjected it to numerous undisclosed risks, including monetary and reputational risks, particularly because advertising is one of CBS' largest revenue sources and any harm to its reputation and/or standing in the business community would adversely affect its current business, as well as its future revenues and growth prospects." See <https://www.rgrdlaw.com/cases-cbscorp.html>. Additionally, a shareholders derivative suit was filed on August 31, 2018 against Nike's Board of Directors entitled *Stein v. Knight*, 18-CV-38553 in the Circuit Court for Oregon following publication of a New York Times article regarding allegations of hostile work environment sexual harassment and gender discrimination at the company. [As pointed out in a recent *D&O Diary* post, while this case is evidence of the continuing trend of litigation in this area, it should be noted that, unlike the other cases discussed in this article, the allegations in the Nike lawsuit don't turn on unwanted advances, inappropriate touching, and the use of corporate power to try to extract sexual favors. Additionally, the first named plaintiff is someone who has filed numerous lawsuits, and has, in fact, been referred to in an article in the *Oregon Business News* about the lawsuit as a "serial litigant." See <https://www.dandodiary.com/2018/10/articles/director-and-officer-liability/nike-board-hit-sexual-misconduct-related-derivative-suit/>.] More recently, a class action complaint was brought against the Trustees of Dartmouth College on November 15, 2018 based on alleged failure to act on and ignoring over a period of more than 16 years of "complaints of pervasive sexual harassment and gender discrimination" allegedly perpetrated by certain professors in the Dartmouth Department of Psychology and Brain Sciences. See Complaint in *Rapuano v. Trustees of Dartmouth College*, Case No. 1:18-cv-01070 (D., NH). The lawsuit seeks \$70 million in damages..

viii. 15 U.S.C. § 78a *et. seq.* (2018).

ix. 17 C.F.R. § 240.10b-5 (2018).

x. *Id.* § 229.103.

xi. *Id.* § 229.303.

xii. Compare *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir 2015) ("Item 303's affirmative duty to disclose in Form 10-Qs can serve as the basis for a securities fraud claim under Section 10(b)."), with *Ash v. PowerSecure Int'l, Inc.*, No. 14 Civ. 92, 2015 WL 5444741, at *11 (E.D.N.C. Sept. 15, 2015) ("[A] violation of SK-303's reporting requirements does not automatically give rise to a material omission under Rule 10b-5.").

xiii. 18 AM. JUR. 2D *Corporations* § 1441 (2018).

xiv. See *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984); *White v. Panic*, 783 A.2d 543, 551 (Del. Sup. Ct. 2001).

xv. See, e.g., Complaint, *Norfolk Cnty. Ret. Sys. v. Wynn*, No. A-18-769062-B, 2018 WL 770483 (Nev. Dist. Ct., Clark Cnty. Feb. 6, 2018); *White*, 783 A.2d 543; *In re Am. Apparel, Inc.*, 2014 Derivative S'holder Litig., No. CV-14-05230-MWF (JEMx), 2015 WL 12724070, at *17 (C.D. Cal. 2015).

xvi. *Sexual Harassment*, EEOC.GOV, www.eeoc.gov/laws/types/sexual_harassment.cfm (last visited Apr. 24, 2018).

xvii. See, e.g., Fair Employment and Housing Act, CAL. GOV'T CODE § 12940 (C) (West 2018);

For purposes of this subdivision, "harassment" because of sex includes sexual harassment, gender harassment, and harassment based on pregnancy, childbirth, or related medical conditions. Sexually harassing conduct need not be motivated by sexual desire.

See also N.Y. EXEC. LAW § 296 (2017); N.Y. CITY ADMIN. CODE §§ 8-502, 8-602 (2018); Eric T. Schneiderman, *Sexual Harassment in the Workplace: Know Your Rights*, N.Y. STATE ATTORNEY GENERAL, https://ag.ny.gov/sites/default/files/sexual_harrassment_brochure.pdf (last visited Apr. 24, 2018); *Taylor v. Nabors Drilling USA, LP*, 166 Cal. Rptr. 3d 676, 683 (Cal. Ct. App. 2014) ("[P]rohibited harassment includes 'verbal, physical, and visual harassment, as well as unwanted sexual advances.'"); *Walsh v. Covenant House*, 664 N.Y.S.2d 282, 283, 244 A.D.2d 214, 215 (N.Y. 1st Dep't 1997);

The State and City Human Rights Laws apply the same Federal standards for determining quid pro quo and hostile environment sexual harassment claims, and differ only in that the City law allows for the recovery of punitive damages.

^{xviii}. 15 U.S.C. § 78a *et. seq.* (2018).

^{xix}. *See* Complaint, Ferris v. Wynn Resorts Ltd., No. 18-cv-01549, 2018 WL 1023165 (S.D.N.Y. Feb. 20, 2018).

^{xx}. *Id.* at ¶¶ 4-5, 25-27, 45.

^{xxi}. *Id.* at ¶¶ 4-5, 49-50.

^{xxii}. *See* Complaint, Irving Firemen's Relief & Ret. Fund v. Signet Jewelers, No. 3:17-cv-00875-D, 2017 WL 1224342 (N.D. Tex. Mar. 28, 2017).

^{xxiii}. *Id.*

^{xxiv}. *Id.* at ¶ 16.

^{xxv}. Drew Harwell, *Hundreds Allege Sex Harassment, Discrimination at Kay and Jared Jewelry Company*, WASH. POST (Feb. 27, 2018), www.washingtonpost.com/business/economy/hundreds-allege-sex-harassment-discrimination-at-kay-and-jared-jewelry-company/2017/02/27/8dcc9574-f6b7-11e6-bf01-d47f8cf9b643_story.html?noredirect=on&utm_term=.a743c25f1f3f; *see also* Lauren Thomas, *This Jewelry Brand's Stock Plummets After Sexual Harassment Allegations Surface*, CNBC (Feb. 28, 2017), www.cnbc.com/2017/02/28/signet-jewelers-stock-drops-as-sexual-harassment-allegations-surface.html.

^{xxvi}. Complaint, *Signet Jewelers*, 2017 WL 1224342, at ¶ 55.

^{xxvii}. *See id.*; *see also* Harwell, *supra* note 25.

^{xxviii}. Complaint, Norfolk Cnty. Ret. Sys. v. Wynn, No. A-18-769062-B, 2018 WL 770483 (Nev. Dist. Ct., Clark Cnty. Feb. 6, 2018).

^{xxix}. *Id.*

^{xxx}. Alexandra Berzon, Chris Kirkham, Elizabeth Bernstein & Kate O'Keeffe, *Dozens of People Recount Pattern of Sexual Misconduct by Las Vegas Mogul Steve Wynn*, WALL ST. J. (Jan. 27, 2018), www.wsj.com/articles/dozens-of-people-recount-pattern-of-sexual-misconduct-by-las-vegas-mogul-steve-wynn-1516985953; *see also* Scott Neuman, *Steve Wynn Resigns As Head of Wynn Resorts amid Sexual Misconduct Allegations*, NPR (Feb. 7, 2018), www.npr.org/sections/thetwo-way/2018/02/07/583895338/steve-wynn-resigns-as-head-of-wynn-resorts-amid-sexual-misconduct-allegations.

^{xxxi}. Complaint, City of Monroe Emps.' Ret. Sys. v. Murdoch, No. 2017-0833 (Del. Ch. Nov. 20, 2017).

^{xxxii}. *Id.* at ¶ 157; *see also* Jonathan Stempel, *21st Century Fox in \$90 Million Settlement Tied to Sexual Harassment Scandal*, REUTERS (Nov. 20, 2017), www.reuters.com/article/us-fox-settlement/21st-century-fox-in-90-million-settlement-tied-to-sexual-harassment-scandal-idUSKBN1DK2NI.

^{xxxiii}. *See, e.g., In re Am. Apparel, Inc., 2014 Derivative S'holder Litig.*, No. CV-14-05230-MWF (JEMx), 2015 WL 12724070, at *17 (C.D. Cal. 2015); *White v. Panic*, 783 A.2d 543 (Del. Sup. 2001).

^{xxxiv}. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996); *see also In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 123 (Del. Ch. 2009):

[T]o establish oversight liability a plaintiff must show that the directors knew they were not discharging their fiduciary obligations or that the directors demonstrated a conscious disregard for their responsibilities such as by failing to act in the face of a known duty to act.

^{xxxv}. *In re Am. Apparel, Inc., 2014 Derivative S'holder Litig.*, 2015 WL 12724070, at *17 (quoting *Stone v. Ritter*, 911 A.3d 362, 370 (Del. 2006)).

^{xxxvi}. *Rattner v. Bidzos*, No. Civ.A. 19700, 2003 WL 22284323, at *13 (Del. Ch. 2003) (quoting *In re Citigroup Inc. S'holders Litig.*, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003)).

^{xxxvii}. *In re Am. Apparel, Inc., 2014 Derivative S'holder Litig.*, 2015 WL 12724070, at *17; *In re Am. Apparel, Inc., S'holder Derivative Litig.*, 2012 WL 9506072, at *29 (C.D. Cal. July 31, 2012); *White*, 783 A.2d 543.

xxxviii. *In re Am. Apparel, Inc., 2014 Derivative S'holder Litig.*, 2015 WL 12724070, at *17; *In re Am. Apparel, Inc., S'holder Derivative Litig.*, 2012 WL 9506072, at *29.

xxxix. *In re Am. Apparel, Inc., S'holder Derivative Litig.*, 2012 WL 9506072, at *29.

xl. *In re Am. Apparel, Inc., 2014 Derivative S'holder Litig.*, 2015 WL 12724070, at *19.

xli. *Id.*

xlii. Complaint, *DiNapoli v. Wynn*, No. A-18-770013-B, at ¶ 1 (Nev. Dist. Ct. Clark Cnty. Feb. 22, 2018).

xliii. *Id.* ¶ 131.

xliv. *Id.* (emphasis added).

xlvi. For a more in-depth analysis of the various claims that a plaintiff may bring against a company and the implications of sexual harassment on corporate law, see the recent and insightful article by Daniel Hemel and Dorothy S. Lund in the *Columbia Law Review*. See *supra* note 1.

xlvii. See Complaint, *Asbestos Workers' Phila. Pension Fund v. Hewitt*, No. 2017-0883, 2017 WL 6336021 (Del. Ch. Dec. 11, 2017).

xlviii. Amended Complaint, *Asbestos Workers' Philadelphia Pension Fund v. Hewitt et al.* at ¶ 3 (Del. Ch. Apr. 17, 2018), No. 2017-0883.

xlix. *Id.*

l. 26 U.S.C. § 162(q) (2018).

1. S. S7507C, 2017–2018 Leg. Sess., subpt. D (N.Y. 2018), www.nysenate.gov/legislation/bills/2017/s7507 (last visited May 24, 2018):

Nondisclosure Agreements. Notwithstanding any other law to the contrary, no employer, its officers or employees shall have the authority to include or agree to include in any settlement, agreement or other resolution of any claim, the factual foundation for which involves sexual harassment, any term or condition that would prevent the disclosure of the underlying facts and circumstances to the claim or action unless the condition of confidentiality is the complainant's preference.

(amending general obligations law with new § 5-336).

li. *Id.* subpt. B (2018) (amending civil practice law and rules with new § 7515).

lii. See S. S7507C, 2017–2018 Leg. Sess. (N.Y. 2018).

liii. See Daniel Wiessner, *Sexual Misconduct Outcry Makes U.S. Lawyers Rethink Confidentiality*, REUTERS (Dec. 19, 2017), www.reuters.com/article/us-usa-misconduct-agreements/sexual-misconduct-outcry-makes-u-s-lawyers-rethink-confidentiality-idUSKBN1ED1DM.

liv. A.B. 1870, 2017–2018 Leg. Sess. (Cal. Apr. 19, 2018) (revised), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB1870.

lv. Rebecca Beitsch, *#MeToo Movement Has Lawmakers Talking About Consent*, HUFFINGTON POST (Jan. 24, 2018), www.huffingtonpost.com/entry/metoo-movement-has-lawmakers-talking-about-consent_us_5a6758dfe4b06bd14be5067f.

lvi. That said, many modern forms have incorporated insuring agreements or optional coverage for discrimination and harassment claims brought by third parties such as customers, clients, and vendors.

lvii. For a more thorough analysis of D&O with EPL insurance coverage, see Kevin LaCroix, *Guest Post: Sexual Misconduct Claims: How Charitable Is Your D&O Policy?*, D&O DIARY (Apr. 19, 2018), www.dandodiary.com/2018/04/articles/director-and-officer-liability/guest-post-sexual-misconduct-claims-charitable-policy.

lviii. Some D&O policies offer crisis fund-type coverage; however, whether such coverage may apply in any given situation will depend on the applicable facts and the policy's wording.

lix. See DAVID E. BORDON & ELLEN B. VAN VECHTEN, 4 LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION § 47:22 (2017).

lx. See *id.* §§ 47:13, 74:26.

lxi. *Id.*

lxii. See 126 F. App'x 235 (6th Cir. 2005).

lxiii. *See* U.S. Specialty Ins. Co. v. Bridge Capital Corp., No. SACV 06-85, 2007 WL 1138863 (C.D. Cal. Apr. 11, 2007).

lxiv. A useful article summarizing some of the issues to consider with regard to D&O insurance for sexual misconduct can be found at LaCroix, *supra* note 57.

lxv. *See* Hemel & Lund, *supra* note 1, at 57.

lxvi. *Id.* at 58.

lxvii. *Id.*

lxviii. *Id.* at 59.

lxix. *Id.*

lxx. *Id.* at 60.

lxxi. *Id.*