INSIGHTS

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The State of Play on Clawbacks — Page 3

JONATHAN M. OCKER, **JUSTIN KRAWITZ**, and **BENJAMIN T. GIBBS** of Pillsbury Winthrop Shaw Pittman LLP examine the policies that companies are implementing to address executive compensation recoupment and forfeiture, as well as the clawback guidelines of institutional investors and proxy advisory firms.

The #MeToo Movement and Securities Litigation — Page 9

KAREN BITAR and **SARAH FEDNER** of Seyfarth Shaw LLP explore the advent of securities class actions and shareholder derivative lawsuits in the wake of the #MeToo movement and protective steps that companies should consider.

SEC Chairman on Offers of Settlement — Page 13

SEC CHAIRMAN JAY CLAYTON discusses the Commission's approach to settlement offers that are accompanied by contemporaneous requests for waivers from automatic statutory disqualifications and other collateral consequences.

DEPARTMENTS

17 IN THE COURTS

Parallel criminal and civil proceedings...

19 STATE CORNER

Third party beneficiaries under stockholder agreements...

21 CLIENT MEMOS

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EXECUTIVE COMPENSATION

The State of Play on Clawbacks and Forfeitures Based on Misconduct

Clawback policies have been common for some time. However, because implementation of the proposed Dodd-Frank clawback rules may never be finalized, companies are beginning to implement or update executive compensation recoupment and forfeiture rules on their own based on investor sentiment, good governance principles, and recent examples of supervisory failure.

By Jonathan M. Ocker, Justin Krawitz, Benjamin T. Gibbs

On July 1, 2015, the Securities and Exchange Commission (SEC) issued proposed rules implementing Section 954 of the Dodd-Frank Act, which would obligate national securities exchanges to adopt listing standards that require listed companies to adopt and disclose clawback policies to recover from current and former executive officers' excess incentive-based compensation attained during the three fiscal years preceding the date on which the company is required to prepare a financial restatement to correct a material error. Unlike the mandatory clawback requirements enforced by the SEC under the Sarbanes-Oxley Act, to which public companies already are subject, under the proposed rules, no fault would be required for the clawback to apply, the clawback would apply to all current and former executive officers (instead of just the chief executive officer (CEO) and chief financial officer (CFO)), and enforcement of the clawback would fall on the issuer as opposed to the SEC.

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However, the rules are only proposed, and there is uncertainty surrounding whether these rules will be finalized in light of the current political landscape. Given this uncertainty, companies are beginning to implement executive compensation recoupment and forfeiture rules on their own, based on investor sentiment, good governance principles, shareholder advisory rules, and recent events at CBS (and other #MeToo moments), Nissan, Equifax, and other examples of supervisory failure.

Advisory Firms Clawback Policies

Companies adopt or adjust recoupment and forfeiture provisions to improve scores on the Institutional Shareholder Services (ISS) Equity Plan Scorecard if their equity plan is being put up for shareholder approval.[1] ISS awards full points to clawback policies that authorize recovery of gains from at least most equity awards in the event of a certain financial restatement. ISS defines "clawback" as a company's ability to recoup performance-based awards (including any cash-based incentive awards, at a minimum) in the event of fraud, restatement of results, errors/omissions, or other activities.

This article includes a sample clawback provision (*see* Exhibit 1), which generally tracks the ISS Equity Scorecard requirements. To enhance enforceability of this sample clawback provision, it should be placed prominently in each cash and performance-based equity award agreement that the participant acknowledges and signs. The portion of this sample provision that is fault-based, and goes into effect before the proposed Dodd-Frank rules are finalized, may result in a "double-jeopardy" situation where it is hard to prove fault when the provision is enforced

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Exhibit 1—Sample Clawback Provision
"In the event that the Company is required to prepare restated financial results owing to an executive officer's intentional misconduct or grossly negligent conduct, the Board of Directors (or a designated committee) shall have the authority, to the extent permitted by applicable law (including California law), to require reimbursement or forfeiture to the Company of the amount of bonus or incentive compensation (whether cash-based or equity-based) such executive officer received during the three fiscal years preceding the year the restatement is determined to be required, to the extent that such bonus or incentive compensation exceeds the amount the executive officer would have received based on an applicable restated performance measure or target. The Company will recoup incentive-based compensation from executive officers to the extent required under the Dodd-Frank Wall Street Reform and Consumer Protection Act and any rules, regulations and listing standards that may be issued under that act. Any right of recoupment under this policy will be in addition to, and not in lieu of, any other rights of recoupment that may be available to the Company."

Exhibit 2—Major Institutional Investors' Clawback Guidelines

Entity	Policy Guidelines
BlackRock	▪ Generally favors recoupment from any senior executive whose compensation was based on faulty financial reporting or deceptive business practices. ▪ Favors recoupment from any senior executive whose behavior caused direct financial harm to shareholders, reputational risk to the company or resulted in a criminal investigation, even if such actions did not ultimately result in a material restatement of past results. This includes, but is not limited to, settlement agreements arising from such behavior and paid for directly by the company. ▪ Typically supports shareholder proposals unless the company already has a robust clawback policy.
JP Morgan	▪ States due consideration should be given to devices such as clawback features in order to align managers and shareholders, incentivize appropriate behaviors, and discourage excessive risk-taking. ▪ Expects clawback features to be present in any variable compensation scheme.
CalPERS	▪ States companies should develop and disclose policies to recapture compensation made to executives during periods of fraudulent activity, inadequate oversight, misconduct including harassment of any kind, which is reasonably expected to impact financial results or cause reputational harm. ▪ Companies should disclose when compensation has been cancelled or recouped consistent with policy.

or, where enforcement is not pursued, when the company faces criticism by shareholders for failure to attempt to enforce the provision.

Institutional Investor Clawback Guidelines

Large investment funds (*e.g.*, BlackRock and CalPERS) also increasingly are encouraging companies to expand these clawback policies to provide discretion covering management misconduct that results in significant reputational harm or adverse publicity unrelated to a financial restatement, and executives who supervise employees who engaged in misconduct. (*See* Exhibit 2.)

In response to the institutional investor guidelines set forth in the exhibit, companies are reviewing their policies in the context of market direction, shareholder sentiment, and the need to balance flexibility to exercise discretion with enforcement issues and

the negative perception of program participants that there are "strings attached."

As a result of this review, while many companies are adopting or modifying their existing clawback policies in a manner intended to meet the proposed Dodd-Frank clawback rules and satisfy ISS, some companies go beyond these minimum requirements and include additional clawback triggers in their clawback policies, such as detrimental behavior and violation of restrictive covenants. However, more aggressive provisions that cover paid cash or stock, or that impose restrictive covenants, may face roadblocks to enforcement.

For example, it remains to be seen the extent to which clawbacks of already paid cash or stock are enforceable, particularly in California, which has a strong public policy favoring the protection of employees' wages. In this respect, California Labor Code Section 221 states that employers may not collect or receive any part of wages previously paid by the employer to an employee. California takes an expansive view of the term "wages," which includes all amounts for labor performed by employees of every description, including bonuses and incentive compensation, but not stock options.

Also, enforcement of clawback provisions tied to violations of restrictive covenants may still be problematic in states that generally disfavor or do not enforce restrictive covenants (*e.g.*, California, where a court would be unlikely to enforce a clawback based on an unenforceable non-compete).

Clawback Policy Comparison

A review of 10 major Silicon Valley companies reveals that the Dodd-Frank proposed rules are driving additional clawback provisions. However, uptake of additional requirements on top of the proposed rules appears to be slow, likely due in part to enforcement issues in California.

Exhibit 3—Clawback Policy Comparison

		Covered Compensation		Trigger			
Company	Covered Population	Cash	Equity	Financial Restatement w/ Misconduct	Any Financial Restatement	Detrimental Activity	Violation of Restrictive Covenants
***	NEOs		x			x	X
Cisco	Executive Officers	x	x		x		
Dell	Executive Officers	x	x	x	x		x
Facebook	n/a	No Clawback Policy Disclosed					
Alphabet	n/a	No Clawback Policy Disclosed					
HPE	Senior Executives	x	x	X		x	x
HP	Senior Executives	x	x	X		x	
Intel	Executive Officers	x	x	X		x	
Microsoft	Senior Executives	x	x	X	x		
Oracle	Executive Officers	x	x	X	x		

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Eight of the 10 major Silicon Valley companies surveyed have clawback policies covering cash and/or equity incentives, with differences in individuals covered and triggering events as detailed in this article's Clawback Policy Comparison Chart (Exhibit 3). The absence of clawbacks at the remaining two, Alphabet and Facebook, may be related to significant inside voting controls.

Seven clawback policies cover cash and equity awards, and one covers only equity. However, it is likely that all eight will move to cover cash and equity, which is what would be required under Dodd-Frank, if the proposed rules are finalized.

Six policies may be triggered by financial restatements involving management misconduct, and four may be triggered by any financial restatement. Dodd-Frank does not require fault, and companies that do not require fault likely do so to avoid derivative lawsuits alleging they failed to enforce a fault-based clawback. Until the proposed Dodd-Frank rules are finalized, those companies that require fault do so because they are thereby only required to enforce clawbacks against responsible parties, *i.e.*, executives whose fault caused a financial restatement.

Four policies may be triggered by detrimental behavior; and another three may be triggered by a violation of restrictive covenants, in each case, without a restatement. These lower percentages likely are due to enforcement issues. For example, as discussed above, non-competes generally are not enforceable in California, which makes it difficult for an employer to assert that it is entitled to a clawback based on violation of a non-compete.

To manage the risk of non-enforceability of clawbacks, these companies also have policies allowing for forfeiture of *unearned*, *unvested* or *unexercised* outstanding cash and equity incentives if an executive is terminated for "cause" or violates post-employment restrictive covenants. In states where forfeiture of earned amounts generally is disfavored (*e.g.*, California), companies should make clear in the award documentation that the compensation is intended as an incentive for future services, and not a reward for past services.

This article's sample equity forfeiture provision (Exhibit 4) is intended to hedge against clawback enforcement issues as discussed above. Counsel should be mindful that this provision can be triggered by mere allegations of misconduct and may want to supplement the provision with language that the compensation committee will act based only on credible evidence of the forgoing actions.

Exhibit 4—Sample Equity Forfeiture Provision

"Upon the Participant's termination of employment with the Company for Cause or to the extent that the Participant otherwise takes such action that would constitute Cause, to the extent legally permissible, any outstanding stock options and RSUs shall immediately terminate. For purposes of this Agreement, "Cause" shall mean "cause" as defined in any employment or consultancy agreement (or similar agreement) or in any letter of appointment then in effect between the Participant and the Company or any Affiliate, or if not defined therein (it being the intent that the definition of "Cause" shall include, at a minimum, the acts set forth below), or if there shall be no such agreement, to the extent legally permissible, (a) the Participant's embezzlement, misappropriation of corporate funds, or other material acts of dishonesty, (b) the Participant's commission or conviction of any felony, or of any misdemeanor involving moral turpitude, or entry of a plea of guilty or nolo contendere to any felony or misdemeanor, (c) engagement in any activity that the Participant knows or should know could harm the business or reputation of the Company or an Affiliate, (d) the Participant's material failure to adhere to the Company's or an Affiliate's corporate codes, policies or procedures as in effect from time to time, (e) the Participant's continued and material failure to meet minimum performance standards as determined by the Company or an Affiliate, (f) the Participant's violation of any statutory, contractual, or common law duty or obligation to the Company or an Affiliate, including, without limitation, the duty of loyalty, or (g) the Participant's material breach of any confidentiality or non-competition covenant entered into between the Participant and the Company or an Affiliate, including, without limitation, the covenants contained in this Agreement. The determination of the existence of Cause shall be made by the Company in good faith, which determination shall be conclusive for purposes of this Agreement."

Exhibit 5—Forfeiture Policy Comparison

Company	Covered Compensation		Trigger			
			Reputational Harm Due To:		Detrimental Activity/ Misconduct Without For-Cause Termination	Violation of Restrictive Covenants
	Cash	Equity	Fraud / Misconduct	Failure to Supervise		
***	x	x				x
Cisco	x	x	x			x
Dell	x	x	x			x
Facebook	x	x				
Alphabet	x	x				
HPE	x	x	x			x
HP	x	x	x		x	
Intel	x	x	x		x	x
Microsoft	x	x				
Oracle	x	x				

Forfeiture Policy Comparison

The forfeiture provisions enacted by the same 10 Silicon Valley companies suggest that market norms and public perception are a governing factor when setting forfeiture policy. In light of recent events, we expect that companies increasingly will provide for forfeiture on account of reputational harm in connection with a "for-cause" termination for fraud or misconduct.

All 10 of the major Silicon Valley companies surveyed have forfeiture provisions in their cash incentive plans and/or equity award agreements. This is not surprising because most cash bonus plans require employment on the date of payment and equity plans provide for the forfeiture of unvested equity irrespective of the nature of the termination. (*See* Exhibit 5.)

All 10 have forfeiture provisions that apply to outstanding equity awards either generally upon any termination of employment or upon a "for-cause" termination to enhance enforceability. The "for-cause" termination provision generally applies to vested but unexercised stock options.

Five companies have forfeiture provisions triggered by reputational harm due to a "for-cause" termination for fraud or misconduct. This lower percentage probably will grow and will apply to vested but unexercised stock options and performance-based restricted stock units (PRSUs) that would continue to vest upon retirement but for a "for-cause" termination, and unvested stock options and restricted stock units (RSUs) where continued vesting is provided in connection with a qualified retirement.

Two companies have forfeiture provisions that are triggered by detrimental activity/misconduct without a corresponding "for-cause" termination, and five have forfeiture provisions that are triggered by a violation of restrictive covenants. These lower percentages are probably attributable to it not being market-competitive to forfeit equity without a termination of employment. As to the restrictive covenants, this normally applies to the lower incidence of providing for continued vesting of equity awards at retirement.

Conclusion

Until the proposed Dodd-Frank rules are finalized, companies should adopt clawback policies

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that, in the event of a financial restatement, give them the discretion to select the executives from which to clawback and whether to recoup cash and equity incentives that were in excess of the amount that should have been paid or earned based on the financial restatement. Based on enforcement issues, companies may not want to expand clawbacks beyond financial restatements or fraud. Companies also should review their executive employment agreements, severance policies, equity award agreements, and cash incentive plans to make sure they have the ability to forfeit unpaid cash bonuses or severance and unvested and/or unexercised equity incentives in the event a CEO or other high-profile executive engages in misconduct, whether or not it results in reputational harm or adverse publicity to the Company. Companies putting their stock plans up for shareholder approval should further consider implementing clawback policies tailored to improve their ISS Equity Plan Scorecard scores.

Note

1. See ISS U.S. Equity Compensation Plans FAQ.

■ SECURITIES LITIGATION

"Event-Driven" Securities Litigation in the #MeToo Era

The #MeToo movement has created new theories of liability and brought about new claims against companies by their shareholders. These include derivative claims alleging corporate mismanagement and securities fraud claims for stock price drops. There, however, are protective steps that companies should consider.

By Karen Bitar and Sarah Fedner

The #MeToo movement has had an enormous impact on corporate America. Workplace harassment and sexual misconduct are not new concepts and have been the focus of litigation for many years. However, the power of the #MeToo movement has created new theories of liability extending beyond the usual employment claims of negligent retention and supervision and/or workplace discrimination typically brought by the alleged victim. A recent development stemming from #MeToo now allows improper workplace conduct to become the gravamen of new claims against the corporation. Notably, these claims are not brought by the victim, but by the corporation's shareholders.

A New Trend?

"Event-driven" securities litigation—where negative events, instead of financial misstatements or omissions, trigger the filing of securities class actions or shareholder derivative lawsuits—is not a new concept. However, the "events" giving rise to such claims have expanded with the advancement of the #MeToo movement, evidencing a trend worthy of note. These suits fall into two categories: (1) derivative claims that corporate mismanagement of #MeToo issues caused a decrease of corporate value;[1] or (2) securities fraud claims that a company's stock price dropped as a result of the corporation's conduct in dealing with #MeToo allegations and the accompanying negative publicity.[2] These claims often are filed quickly after the event, with less investigation and witness involvement than the more traditional financial fraud cases. This haste may result in an inability to adequately allege scienter, resulting in successful motions to dismiss filed by defendants. Event-driven litigation, such as the #MeToo cases, has contributed to the overall recent increase in securities filings.

The first category of shareholders' #MeToo actions alleges a corporation's value was diminished due to corporate mismanagement of #MeToo allegations. What kind of corporate mismanagement is out there? Allegations include a company ignoring misconduct, a company's failure to sanction misconduct, and a failure to initiate appropriate safeguards against misconduct, all of which allowed a hostile work environment to thrive. Similarly, paying victims to remain silent through the use of nondisclosure agreements (NDA), or approving generous severance packages to make wrongdoers go away quietly, also may be alleged as corporate mismanagement. Shareholders allege that when this corporate malfeasance is disclosed, the corporation experiences reputational harm and its stock loses value, giving rise to a derivative claim.

The second category of shareholders' #MeToo actions, securities fraud cases, is framed a little differently. These claims are brought under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 promulgated thereunder and allege the company made materially false and misleading statements to the investing public. These lawsuits tend to follow a particular pattern: Asserting that the corporation engaged in a cover up of the abuse, failed to take

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adequate steps when faced with allegations of abuse by key personnel, or failed to truthfully disclose what steps it did or did not take to deter, investigate or curb abuse after allegations of abuse became public. Alternatively, these lawsuits may allege that a company professed it had integrity, high ethical standards and sound internal policies, including a no tolerance policy for sexual misconduct, but did not uphold such standards. These cases allege that subsequent disclosure of the true facts, including that the company's purported ethical standards were not as rigorous as asserted, or that the officers and directors knew of such misconduct and did not take action, led to a stock price decline.

Both derivative claims and securities fraud claims have pleading challenges.

As a result, public companies now find themselves, their boards and their senior management, as defendants in securities class actions or derivative actions. These claims are being filed with increasing frequency and courts are letting them proceed.

Nevertheless, both derivative claims and securities fraud claims have pleading challenges. Derivative claims need to plead demand futility with particularity. Claims under Rule 10b-5 also must be pled with particularity under Rule 9(b) and the Private Securities Litigation Reform Act's (PSLRA) heightened pleading standard. Companies often are successful in defending derivative claims on the basis of the pre-suit demand requirements and the business judgment rule. Companies are defending these securities class actions by claiming that their representations regarding the existence of good corporate governance are non-actionable puffery, do not impact the "total mix" of information available to investors, and that, in any event, there is no duty to disclose the alleged wrongdoing.

The Problems at CBS

Take for example the putative class action for securities fraud brought by CBS shareholders against CBS and certain of its executives, including ex-chief executive officer (CEO) Leslie Moonves.[3] The amended complaint, filed in February (Amended Complaint), received significant media attention.[4]

The Amended Complaint alleges misrepresentations by CBS and its executives relating to their efforts to quash sexual harassment in the workplace. Add to that are allegations that Moonves, Joseph Iannelli the Chief Operating Officer, Lawrence Liding the Chief Accounting Officer, and Communications Director Guild Schwartz, collectively sold over 3.4 million shares of CBS stock, valued in excess of $200 million, to an unsuspecting public during the class period. Plaintiffs allege that the executives sold because they knew what the investors did not: that the allegations against Moonves were mounting. The Amended Complaint further alleges that the failure to disclose these facts violated the antifraud provisions of the Exchange Act. Specifically, it alleges that these top executives misrepresented compliance with internal anti-harassment policies, and hid the severity of the allegations against Moonves, TV journalist Charlie Rose, and others, which artificially inflated the value of CBS stock and caused investors to lose money when the stock price dropped as various allegations became public.

Plaintiffs claim that CBS held itself out to have "the highest standards of ethical and appropriate business actions," a "zero tolerance policy for sexual harassment," and a prohibition on "discriminatory treatment including sexual harassment."[5] Yet, after touting these values, allegations about Moonves' proclivities and CBS' alleged widespread culture of harassment were exposed in detail over a period of months.[6] The Amended Complaint also references other examples of wrongdoing, including that CBS and its executives fostered a company-wide pattern of harassment and hostile work environment—one which was diametrically opposed to the company's public statements.[7] Moreover, the company allegedly did not disclose the risk that Moonves would step down as CEO as the claims mounted against him, but instead, represented him to be a "key executive."[8] The Amended Complaint further alleges that the company also failed to disclose significant settlements with female employees that reported mistreatment.[9] These, and other

alleged material omissions, came to light at various junctures over the class period leading to lawsuits. The alleged loss of stock value occurred after July 27, 2018, media reports that the *New Yorker* would publish an exposé discussing sexual misconduct by Moonves, an August 6, 2018, disclosure revealing more details of "Moonves and CBS' sexual misconduct," and the *New Yorker* exposé on September 9, 2018, where CBS announced that Moonves would be stepping down as the company's chairman and CEO.[10]

CBS and the individual defendants filed a motion to dismiss on April 12, 2019. They argue, *inter alia*, that CBS did not make any material misrepresentation or omissions, that allegations of "company-wide" harassment are too vague and conclusory to be actionable, that rumor and innuendo about Moonves are not statements of material fact and thus not violative of federal securities laws, nor that there is any statute or regulation "expressly requiring the disclosures that plaintiffs claim defendants were obligated to make." They also argue failure to adequately allege *scienter*, as there are no plausible allegations of a motive to defraud, and a failure to adequately allege loss causation.

On June 11, 2019, Plaintiffs filed opposition briefs arguing that the Amended Complaint sufficiently alleges particularized misstatements and omissions, including, *inter alia*, that: (1) the zero tolerance policy in CBS' code of conduct was "directly at odds" with CBS' actions; (2) Defendants' statements to the media about the importance of a harassment-free environment and CBS' commitment to swiftly addressing allegations of sexual misconduct were false and misleading given Defendants' knowledge of the allegations against Moonves; and (3) CBS' statements about "the critical importance of Moonves to CBS' business" were false and misleading because they omitted the mounting allegations against Moonves and the risk he may leave the company. Plaintiffs assert that the Amended Complaint sufficiently alleges *scienter*, because: (1) Defendants knew or should have known about the allegations against Moonves; (2) the suspicious timing of Defendants' stock sales gives rise to *scienter*; and (3) individual executives' knowledge of the sexual harassment allegations can be imputed to CBS in order to establish corporate *scienter*. They also argue that loss causation was pled sufficiently, because the Amended Complaint states that CBS' stock "soared" after Defendants' misstatements concerning CBS' sexual harassment policies and the importance of certain key executives, but "plummeted" after CBS' culture of sexual misconduct was made public by the media.

Notably, Plaintiffs assert that the

> #MeToo movement forced companies to consider heightened disclosure obligations given the enhanced likelihood that, . . . allegations of sexual misconduct will be exposed and can reasonably be expected to materially affect a company's revenues, and consequently, its stock price.

Plaintiffs further argued that, pursuant to Item 303 of Regulation S-K, CBS had an "independent duty" to disclose these allegations in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections of their Form 10-Q and Form 10-K filings. Defendants have yet to file a reply.

What Should a Company Do Now to Avoid a Similar Fate?

Sophisticated plaintiffs lawyers now know that cases stemming from a #MeToo event can present a new basis to assert claims, and will use the precedent from cases that have survived motions to dismiss to draft new complaints. Knowing this, what steps should you consider taking to protect your company now?

Company Statements. What is the company disclosing and how can it be challenged? Simply, if the company is making public statements about its comprehensive policies and procedures as to sexual misconduct in the workplace, it needs to strictly enforce them. If the company will not, it is better to say nothing at all about its corporate culture.

Board Considerations. Consider the board's role in preventing and responding to sexual harassment

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allegations. How and when does it become involved? Are its responses independent and reasonable, or a mere rubber stamp of management's actions? Is the board promptly advised of significant issues of misconduct, and if so, does it take decisive action to ensure the company is protected against the type of claims shareholders now can file when allegations of sexual abuse become known?

Employee Considerations. Employees are a valuable resource in uncovering systematic misconduct. They should receive regular and comprehensive trainings regarding anti-harassment policies, including where to report any potential misconduct. A company hotline for reporting sexual harassment allegations may be a useful tool. Companies also should consider whether to implement health and safety surveys in order to uncover violations of company policies.

Compliance Programs. Look at the company compliance framework. The company's compliance program must be reviewed regularly, updated as necessary, distributed at regular intervals, and enforced from the top down. Corporate counsel needs to ensure awareness of, and compliance with, federal and state laws, and with best practices generally. As new program requirements are rolled out, training should follow. Attention is needed to keep compliance documents contemporary and relevant.

Internal Investigations. Consider conducting an independent, internal investigation to identify not only actual allegations of sexual harassment, but also the less obvious rumors and innuendo, so as to identify and remedy these issues before lawsuits and reputational harms occur. All allegations should be taken seriously. At the very least, companies should conduct a fulsome investigation in response to all complaints of abuse or other red flags.

Obtain Legal Advice. Contemplate obtaining legal advice regarding whether internal investigation findings or general allegations of sexual misconduct need to be disclosed. This is especially true where there are repeated allegations of sexual misconduct or the alleged misconduct involves senior executives.

Nondisclosure Agreements. In some jurisdictions, such as New York, New Jersey, and California, the use of NDAs in settlements pertaining to sexual harassment and discrimination is restricted. Where they are permitted, carefully consider NDAs or confidentiality provisions, recognizing that such provisions may be perceived as buying silence of the alleged victim, and shielding the alleged perpetrator. It is prudent to review the law in your jurisdiction.

It will be interesting to see if, and how, event-driven litigation relating to #MeToo makes its way through the courts but taking defensive measures now, to guard against whatever that eventuality might be, is a step in the right direction.

Notes

1. *See, e.g.*, Asbestos Workers' Philadelphia Pension Fund v. Hewitt, Case No. 2017-0883 (Del. Ch.).
2. *See, e.g.*, Construction Laborers Pension Trust for Southern California v. CBS Corp., No. 1:18-CV-07796 (S.D.N.Y); Luczak v. National Beverage Corp., Case 0:18-cv-61631-KMM (S.D. Fla.).
3. Other publicly traded companies have experienced a similar plight of securities litigation stemming from #MeToo allegations. For example, on December 11, 2017, the shareholders of Liberty Tax, Inc. filed a derivative action in Delaware Chancery Court against the company and its former CEO alleging the CEO breached his fiduciary duties by diverting company assets to further his sexual relationships with female employees. As another example, on July 17, 2018, the shareholders of National Beverage Corporation, the company responsible for LaCroix sparkling water, filed a class action in the Southern District Court of Florida alleging the company made false and misleading statements regarding the former CEO's sexual harassment of pilots on corporate jets.
4. *See* Amended Complaint, Construction Laborers Pension Trust for Southern California v. CBS Corp., No. 1:18-CV-07796 (S.D.N.Y) filed February 13, 2019.
5. *See, e.g.*, Amended Complaint ¶ 4.
6. *See, e.g.*, *id.* ¶¶ 9, 11-14.
7. *See, e.g.*, *id.* ¶ 75, 98(a), 109, 107-108, 123(a).
8. *See, e.g.*, *id.* ¶¶ 6, 98(e).
9. *See, e.g.*, *id.* ¶¶ 64-65, 74-75, 85.
10. *See, e.g.*, *id.* ¶¶ 20, 21, 145-146, 155-156.

SECURITIES ENFORCEMENT

Statement Regarding Offers of Settlement

The SEC Chairman discusses his views on the factors that affect negotiations of settlements of SEC enforcement actions and the Commission's approach to settlement offers that are accompanied by contemporaneous requests for waivers from automatic statutory disqualifications and other collateral consequences.

By Chairman Jay Clayton

When the Securities and Exchange Commission (SEC) is considering filing (or has filed) an action alleging violations of the federal securities laws, it often is in the public interest to pursue a timely, reasonable and consensual resolution of the matter. The SEC has long recognized that an appropriately-crafted settlement can be preferable to pursuing a litigated resolution, particularly when the settlement is agreed early in the process and the SEC obtains relief that is commensurate with what it would reasonably expect to achieve in litigation. In plain language, the sooner harmed investors are compensated, the offending conduct is remediated, and appropriate penalties are imposed, the better.

I have been considering the factors that affect settlement negotiations and settlement agreements with an eye toward enhancing outcomes for investors and most effectively utilizing our resources.[1] This statement discusses my views on some of those factors and specifically addresses the SEC's approach to settlement offers that are accompanied by contemporaneous requests for SEC waivers from automatic statutory disqualifications and other collateral consequences.

SEC Chairman ***Jay Clayton*** *issued this statement on July 3, 2019.*

Factors that Drive Appropriate Settlements

It often is noted that the cost of litigation—or, more accurately, avoiding the cost of litigation—is a key driver of settlements. This is undoubtedly correct, as that cost—in terms of dollars as well as other less-tangible factors—can be significant for many defendants.[2]

There, however, are other factors that can drive appropriate settlements. One important factor is the demonstrated willingness of the SEC to litigate zealously if a timely and reasonable offer of settlement is not made. When no such offer has been made, I believe we should promptly file an action and pursue all appropriate remedies. Our practice reflects this principle.[3] In addition, we are bolstering, and expect to continue to bolster, our trial and trial-support resources.[4]

Another factor that drives appropriate settlements is the importance of promptly remedying harm to investors. Investor protection is at the core of the SEC's mission and, from the SEC's perspective, an attractive settlement offer is one that provides appropriate remedial relief, including any return of money to injured investors, more quickly than would be expected in a litigated action.[5] I encourage settling parties to craft their settlement offers with this perspective in mind and also to be flexible and creative to maximize the remedial effects of proposed settlements.

A fourth factor that drives appropriate settlements is a desire for certainty. In particular, the ongoing and potential consequences of a litigated action often motivate an entity to pursue a settlement that puts the matter behind it. The SEC's ability to provide such certainty can be another critical factor in reaching a settlement that is in the best interest of investors. Put simply, the SEC's willingness to zealously

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pursue all appropriate remedies often is a strong stick and, at the same time, the ability of the SEC to provide a full and final resolution of a matter often is a significant carrot.

Pursuing a settlement agreement that provides certainty can be complex, including because the imposition of certain types of relief by the SEC and other authorities can have significant collateral consequences.[6] For example, remedies such as the imposition of an injunction against future violations of the antifraud provisions of the federal securities laws, or the requirement that an entity undertake to retain an independent compliance consultant, may subject the entity to collateral disqualifications that, as a practical matter, can prohibit the entity from continuing to conduct certain businesses.[7] The effects of these collateral consequences can vary widely depending on the scope of the businesses and operations of the entity and, in practice, range from immaterial to extremely significant. In certain cases, these collateral consequences are wholly appropriate, including to serve important investor protection considerations. In other cases, in whole or in part, they may not be, including because other measures may more appropriately address the conduct at issue and related investor protection considerations.[8]

Pursuing a settlement agreement that provides certainty can be complex.

In many cases, the SEC has the authority to grant a waiver from these collateral consequences, either in full or subject to conditions. In these circumstances, parties seeking settlements often make contemporaneous settlement offers and waiver requests.

The SEC has followed a practice where a decision to grant, deny or condition the grant of a waiver is informed by a recommendation from one or both of the Divisions of Corporation Finance and Investment Management or determined by the staff pursuant to delegated authority.[9] The analysis informing this recommendation or determination can be complex because, for example, the businesses and operations of the entity affected by the collateral disqualifications may or may not be related to the conduct at issue, and the collateral consequences can range from immaterial to extremely significant and may or may not have an impact on investor protection. The robust analysis performed by the Divisions of Corporation Finance and Investment Management has proven critical to the SEC's consideration of these issues.

Considering a settlement offer and a related waiver request as if they are two separate and unconnected events can add complexity.

Although settlement offers and waiver requests generally have been made contemporaneously, and resolution of both often is critical to achieving the necessary level of certainty, in recent years, the SEC has considered these matters almost exclusively on a segregated basis. Considering a settlement offer and a related waiver request as if they are two separate and unconnected events can add complexity, including because such a formulaic separation often is inconsistent with appropriate consideration of the substance and interconnected nature of the matters at issue and undermines factors that drive appropriate settlements. The complexity added by such a separation can substantially complicate and lengthen the negotiating process, which, among other consequences, may not lead to the best outcome for investors and can unnecessarily tap SEC resources.[10]

Forms of Contemporaneous Settlement Offers and Waiver Requests

Recognizing that a segregated process for considering contemporaneous settlement offers and waiver

requests may not produce the best outcome for investors in all circumstances, I believe it is appropriate to make it clear that a settling entity can request that the SEC consider an offer of settlement that simultaneously addresses both the underlying enforcement action and any related collateral disqualifications. To be more specific and to discuss the issue in context, an offer of settlement that includes a simultaneous waiver request negotiated with all relevant divisions (*e.g.*, Enforcement, Corporation Finance, Investment Management) will be presented to, and considered by, the SEC as a single recommendation from the staff.[11] This approach will honor substance over form and enable the SEC to consider the proposed settlement and waiver request contemporaneously, along with the relevant facts and conduct, and the analysis and advice of the relevant SEC divisions to assess whether the proposed resolution of the matter in its entirety best serves investors and the SEC's mission more generally.[12]

The SEC, of course, is under no obligation to accept any settlement offer and may determine not to accept a simultaneous offer of settlement and waiver request on the basis of form alone.

I have consulted with the Office of the General Counsel and the Division of Enforcement regarding the mechanics of the SEC's consideration of a simultaneous offer of settlement and waiver request. Based on these discussions, I generally expect that, in a matter where a simultaneous settlement offer and waiver request are made and the settlement offer is accepted but the waiver request is not approved in whole or in part, the prospective defendant would need to promptly notify the Staff (typically within a matter of five business days) of its agreement to move forward with that portion of the settlement offer that the SEC accepted. In the event a prospective defendant does not promptly notify the staff that it agrees to move forward with that portion of the settlement offer that was accepted (or the defendant otherwise withdraws its offer of settlement), the negotiated settlement terms that would have resolved the underlying enforcement action may no longer be available and a litigated proceeding may follow.

Notes

1. Since arriving at the SEC in May 2017, I have consulted with the directors of the Divisions of Enforcement, Corporation Finance and Investment Management, as well as various others, including my fellow Commissioners, on how to improve the effectiveness and efficiency of our consideration of settlement offers, waiver requests and related matters.
2. Appropriate settlements, particularly those settlements that occur without undue delay, provide savings to the SEC as well. Among other things, they allow the SEC to allocate resources that would be used in support of any given litigation to other matters.
3. For example, the SEC prevailed on *scienter* based fraud charges in SEC v. Johnston, 368 F. Supp. 3d 247 (D. Mass. 2019); SEC v. Present, No. 14-cv-14692 (D. Mass. Mar. 20, 2018); SEC v. Revolutions Med. Corp., No. 12-cv-03298 (N.D. Ga. Mar. 16, 2018); and SEC v Fowler, No. 17-cv-00139 (S.D.N.Y. June 21, 2019). Moreover, in any given year, the SEC brings and wins numerous cases based on affirmative summary judgment motions.
4. We recently lifted our hiring freeze, enabling us to fill positions vacated as a result of retirements and other departures, and, in addition, expect to add over 100 positions in 2019 across the SEC, with an emphasis on the Division of Trading and Markets, the Office of Compliance Inspections and Examinations and the Division of Enforcement.
5. *See, e.g.*, SEC Press Release 2019-28, SEC Share Class Initiative Returning More Than $125 Million to Investors (Mar. 11, 2019), available *at https://www.sec.gov/news/press-release/2019-28.*
6. *See, e.g.*, 15 U.S.C. § 77z-2(b)(1)(A); 15 U.S.C. § 78u-5(b)(1)(A); 15 U.S.C. § 80a-9(a); 17 C.F.R. § 227.100 et seq.; 17 C.F.R. §§ 230.262, 230.405, 230.504(b)(3), 230.506(d), 230.602(b)-(e); 17 C.F.R. § 275.206(4)-3(a)(1)(ii)(C).
7. Such collateral consequences may include: loss of well-known seasoned issuer (WKSI) status for the purposes of securities offerings; loss of statutory safe harbors under the Securities Act of 1933 (Securities Act), and the Securities Exchange Act of 1934 (Exchange Act), for forward-looking statements, which were added by the Private Securities Litigation Reform Act of 1995 (PSLRA); loss of private offering exemptions provided by

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Regulations A, D and Crowdfunding under the Securities Act; loss of the exemption from registration under the Securities Act for securities issued by certain small business investment companies and business development companies provided by Regulation E; and the prohibition on a registered investment adviser from receiving cash fees for solicitation under Rule 206(4)-3 of the Investment Advisers Act of 1940 (Advisers Act).

8. *See, e.g.*, Revised Statement on Well-Known Seasoned Issuers (April 24, 2014), available at *http://www.sec.gov/divisions/corpfin/guidance/wksi-waivers-interp-031214.htm*; Waivers of Disqualification under Regulation A and Rules 505 and 506 of Regulation D (March 13, 2015), available at *https://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml*.
9. The Division of Corporation Finance and the Division of Investment Management exercise their expertise to make recommendations to the SEC with regard to requests for waivers from disqualification and also act within the scope of their delegated authority. *See, e.g.*, 17 C.F.R. § 200.30-1(b)-(d); 17 C.F.R. § 200.30-1(a); 17 CFR 200.30-5(a).
10. By way of example, in a case where a settlement that is in the best interest of investors would require an entity to undertake to retain an independent compliance consultant, and the agreement to retain that consultant would be the event that triggers a collateral disqualification, an entity may, absent the ability to submit a simultaneous settlement offer and waiver request, refuse to propose such a term of settlement. In circumstances where other authorities are considering actions involving the same or related conduct, complexity can increase and the ability for the authorities to provide collective certainty can be a significant driver of appropriate settlements.
11. The SEC should continue to review and consider the policy divisions' staff analysis. I expect that the analysis performed by the policy divisions regarding the appropriateness of a waiver of an automatic disqualification will continue to be rigorous and fair, and, in the context of determining whether the applicant has met the applicable standard for the waiver, will continue to result in what is best for the protection of investors, the markets and the public, as well as the promotion of market integrity. For a more detailed discussion of the staff's process in considering enforcement actions and waiver requests, *see* Brief for Harvey L. Pitt *amicus curiae* at 9-15, U.S. Sec. & Exch. Comm'n v. Citigroup Global Markets, Inc. 752 F.3d 285 (2d Cir. 2014); Chair Mary Jo White, Understanding Disqualifications, Exemptions and Waivers Under the Federal Securities Laws (Mar. 12, 2015), available at *https://www.sec.gov/news/speech/031215-spch-cmjw.html*.
12. The SEC permitted these types of simultaneous settlement offers and waiver requests in the past (often they were framed as an offer of settlement contingent upon the receipt of a specified waiver). The Directors of the Divisions of Enforcement, Corporation Finance and Investment Management, as well as other senior members of the Enforcement Division, believe that returning to the practice of permitting simultaneous offers of settlement and waiver requests will benefit investors and the SEC's mission more generally.

IN THE COURTS

Parallel Criminal and Civil Investigations: Good Faith of United States Attorney's Office Called into Question

By Andrew M. Lankler, Lynn A. Neils, and Joseph Perry

In *United States v. Rhodes*, a federal district court case arising out of a parallel investigation conducted by the Criminal Division of the United States Attorney's Office for the Southern District of New York (USAO) and the Securities and Exchange Commission (SEC), the Court recently directed the USAO to furnish a supplemental affidavit to the Court for *in camera* review, "detailing with specificity, the nature and extent of any and all communications between the SEC and those involved in the criminal investigation of [the defendant]."[1] The Court's order stems from allegations made by the defendant that the USAO, in bad faith, took advantage of the civil discovery process in the parallel SEC proceeding to build a criminal case against the defendant in violation of his due process rights.

Factual Background

The USAO secured an indictment against defendant Jason Rhodes in December 2018, charging him with conspiracy, securities fraud, wire fraud, and investment adviser fraud in connection with an alleged $19.6 million scheme to defraud investors in the hedge fund Sentinel Growth Fund Management LLC (Sentinel). A few months thereafter, defendant Rhodes filed a motion with the Court, requesting that the USAO produce documents concerning its coordination with the SEC with respect to this criminal proceeding. Rhodes argued in his motion that he was entitled to this discovery because the circumstances of his indictment strongly suggested that the USAO used the SEC's civil discovery process to develop the criminal case against him.

According to Rhodes, those questionable circumstances included the following: (1) the USAO had criminally charged defendant Rhodes' alleged co-conspirators, but not the defendant himself, almost two years earlier in January 2017; (2) the SEC issued a third-party witness subpoena to the defendant in February 2017 shortly after it instituted civil proceedings against Sentinel and one of the already indicted co-conspirators; (3) the SEC collected voluminous data from Rhodes, including cell phone data and other communications, and turned that data over to the USAO, which the USAO then used to bring charges against Rhodes; and (4) the SEC ended its investigation against the defendant—without charging Rhodes—prior to his arrest in the criminal action. Taken together, the defendant argued that these circumstances give rise to an inference that the sole purpose of the SEC's civil subpoena was to assist the USAO in its prosecution of Rhodes. Opposing the motion, the USAO urged the Court to decline the defendant's discovery request because Rhodes' assertions surrounding the USAO's purported improper coordination with the SEC were purely speculative.

Analysis

There is no dispute that the propriety of parallel criminal and civil investigations has long been upheld by the US Supreme Court.[2] Provided that the criminal authorities have acted in good faith and with proper procedures, the evidence obtained by a

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civil regulator during the course of its investigation can be used in connection with a subsequent criminal action.[3] Defendants objecting to a prosecutor's use of evidence collected in a civil action have the burden of establishing that the criminal authorities acted in bad faith.[4] Bad faith may be shown, *inter alia*, where the Government has "brought a civil action solely to obtain evidence for its criminal prosecution or has failed to advise the defendant in its civil proceeding that it contemplates his criminal prosecution."[5]

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A motion seeking discovery on the issue of bad faith only will be granted where a defendant can "make a substantial preliminary showing" that the criminal authorities indeed acted in bad faith.[6] To do so, a defendant's moving papers must be "sufficiently definite, specific, detailed, and nonconjectural to enable the court to conclude that contested issues of fact . . . are in question."[7]

Mindful of this precedent, the Court in *Rhodes* observed that the Second Circuit had adopted the "substantial preliminary showing" standard in a case where the criminal authorities had supplied the district court with multiple affidavits outlining "the relationship between the civil and criminal investigations at issue and had submitted documents for the court's in camera review." During the pendency of the defendant's motion, the Court urged the USAO to submit an affidavit describing the nature of the coordination between the SEC and the USAO regarding the defendant's criminal prosecution. Although the USAO submitted an affidavit in response to the Court's request, the Court concluded that the affidavit was inadequate because it was "conspicuously limited" to the conduct of one Assistant US Attorney and said "nothing about the knowledge or involvement of others" within the USAO. Accordingly, the Court held defendant's motion in abeyance, directing the USAO to submit a more complete submission "detailing, with specificity, the nature and extent of *any and all* communications between the SEC and those involved in the criminal investigation of Rhodes." The Court further directed the USAO to attach copies its substantive communications with the SEC to its submission. (Editor's note: On July 16, 2019, the Court stated that the records the USAO turned over did not support the idea that the civil investigation was an arm of the prosecution.)

Implications

Parallel criminal and civil investigations, in today's complex regulatory and enforcement climate, are more common than ever. In many cases, as in *Rhodes*, the criminal authorities first surface long after the civil investigative process is underway. Parties subject to a civil investigation by a regulator who are even remotely concerned that the investigation could lead to a criminal referral should from the outset seek counsel adept at handling matters both before the civil regulator and the criminal authorities. Retaining counsel trained at identifying when the criminal authorities may have "crossed the line" and abused the civil discovery process is just one of the ways counsel can preserve the due process rights of an accused.

Notes

1. United States v. Jason Rhodes, 18-CR-887 (JMF) (S.D.N.Y. June 18, 2019)
2. *See* United States v. Kordel 397 U.S. 1 (1970).
3. *See id.* at 11-12.
4. *See, e.g.,* United States v. Mahaffy, 446 F. Supp. 2d 115, 123 (E.D.N.Y. 2006) (*quoting* United States v. Teyibo, 877 F. Supp. 846, 855 (S.D.N.Y. 1995)) ("[t]he prosecution may use evidence acquired in a civil action in a subsequent criminal proceeding unless the defendant demonstrates that such use would violate his constitutional rights or depart from the proper administration of criminal justice.").
5. *Kordel*, 397 U.S. at 12-13; *see also Mahaffy*, 446 F. Supp. 2d at 124.
6. United States v. Gel Spice Co., 773 F.3d 427, 432 (2d Cir. 1985).
7. United States v. Watson, 404 F.3d 163, 167 (2d Cir. 2005).

STATE CORNER

Stockholder Has Standing to Sue as Third Party Beneficiary for Breach of Stockholder Agreement

By John T. Bradley and David A. Rosenfield

The Delaware Court of Chancery recently held, *In Arkansas Teacher Retirement System v. Alon USA Energy, Inc. et al.*,[1] that a stockholder of a Delaware corporation is a third party beneficiary of a stockholder agreement that includes protections similar to those contained in Section 203 of the Delaware General Corporation Law, and therefore has standing to sue for breach of the agreement.[2]

Background

Delek US Holdings, Inc. acquired 48 percent of the common stock of Alon USA Energy, Inc. from Alon's largest stockholder in 2015. At the time, Delek expressed interest in acquiring the entirety of Alon's outstanding shares. To avoid the three-year standstill period imposed under Section 203 of the Delaware General Corporation Law, Delek requested and obtained Section 203 pre-approval from Alon's board, but the board conditioned its approval on Delek entering into a stockholder agreement. The stockholder agreement established anti-takeover protections similar to those imposed by Section 203, but for a period of only one year.

Delek and Alon ultimately negotiated the terms of a merger transaction, which was agreed to in January 2017, approved by Alon's stockholders in June 2017 and consummated in July 2017.

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The Court Determined the Plaintiff Can Sue as Third Party

The Plaintiff, an Alon stockholder at the time of the merger, brought various claims against Delek, Alon and their respective directors, including for breach of fiduciary duty, breach of the stockholder agreement and that the merger was prohibited under Section 203 and therefore void *ab initio* and thus constituted an act of conversion.

Under Delaware law, a third party to an agreement may sue to enforce the agreement's terms if three elements are met:

1. The contracting parties intended to confer a benefit directly to that third party;
2. They conveyed the benefit as a gift or in satisfaction of a pre-existing obligation; and
3. Conveying the benefit was a material part of the purpose for entering into the agreement.

The Court determined that the stockholder agreement's relationship to Section 203 rendered each of these elements satisfied. The stockholder agreement replicated many aspects of the anti-takeover protections of Section 203, which provide a direct benefit to stockholders of a Delaware corporation; therefore, the Court reasoned, the stockholder agreement provided a direct benefit to the Plaintiff. The agreement's benefits were established in place of Section 203's pre-existing protections, or were at least intended as a gift to the stockholders. The Court found that the purpose of the stockholder agreement was to restrict Delek's ability to acquire Alon, thus without the anti-takeover provisions, the agreement would not achieve that purpose. The Court determined that the anti-takeover provisions were material and held that the Plaintiff has standing to enforce the stockholder agreement.

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Violation of Stockholder Agreement May Restore Protections under Section 203

The Plaintiff also asserted that Delek and Alon violated Section 203 by entering into the merger, arguing that Delek's violation of the stockholder agreement vitiated the approval of Alon's board under Section 203, thereby restoring Section 203's protections. The Plaintiff argued that since the protections were restored, Section 203 prohibited the merger, therefore the merger was void *ab initio* and thus when consummated constituted an act of conversion. Although the case is ongoing and the Court has yet to rule on Plaintiff's line of reasoning, the Court rejected the Defendants' argument that the alleged Section 203 deficiencies were necessarily cured through Section 203(a)(3) upon approval by Alon's board and two-thirds of its disinterested stockholders on the basis that the Plaintiff adequately alleged that stockholder approval was not fully informed. In other words, the curative power of board and disinterested stockholder approval under Section 203(a)(3) must still meet the condition of fully-informed decision-making to cleanse a Section 203 violation.

The Plaintiff's breach of fiduciary duty claims survived Defendants' motion to dismiss and are headed toward either the business judgment or entire fairness standard of review, in-line with recent Delaware Supreme Court cases *Kahn v. M & F Worldwide Corp.*[3] and *Flood v. Synutra International, Inc.*[4]

While this case may or may not break new ground on the novel pending Section 203 claims, buyers, sellers, and M&A practitioners should be aware that in certain circumstances, third party stockholders of a Delaware corporation may have standing to sue for breach of a stockholder agreement between the corporation and a stockholder.

Notes

1. In Arkansas Teacher Retirement Sys. v. Alon USA Energy, Inc. *et al.*, C.A. No. 2017-0453-KSJM, 2019 WL 2714331 (Del. Ch. June 28, 2019).
2. Under Section 203 of the Delaware General Corporation Law, a stockholder who has bought more than 15 percent of a company's stock cannot participate in certain business combinations with the company for a period of three years unless certain conditions are met.
3. *http://courts.delaware.gov/opinions/download.aspx?ID=202790.*
4. *https://courts.delaware.gov/Opinions/Download.aspx?id=279580.*

CLIENT MEMOS

A summary of recent memoranda that law firms have provided to their clients and other interested persons concerning legal developments. Firms are invited to submit their memoranda to the editor. Persons wishing to obtain copies of the listed memoranda should contact the firms directly.

Cadwalder, Wickersham & Taft LLP
New York, NY (212-504-6000)

Another Merger Challenge Demonstrates the Limits of *Corwin* (July 8, 2019)

A discussion of two 2018 Delaware Supreme Court decisions tempering the force of its 2015 *Corwin* decision and signaling its receptiveness to arguments that merger-related disclosures contained misstatements or omissions.

Cleary, Gottlieb, Steen & Hamilton LLP
New York, NY (212-225-2000)

Proposed Bad Actor Disqualification Act (July 9, 2019)

A discussion of legislation introduced by the Chair of the House Financial Services Committee, the "Bad Actor Disqualification Act of 2019, which would dramatically increase the burdens on institutions seeking waivers from disqualifications under the federal securities laws.

Davis Polk & Wardwell LLP
New York, NY (212-450-4000)

SEC and FINRA Staffs Highlight Broker-Dealer Regulatory Challenges Raised by Digital Assets (July 12, 2019)

A discussion of a joint statement of the staffs of the SEC and FINRA outlining their concerns about broker-dealers' ability to comply with the financial responsibility rules for business activities involving digital assets that are securities,

Dechert LLP
Philadelphia, PA (215-994-4000)

SEC Provides No-Action Relief for Index-Based Funds (June 27, 2019)

A discussion of a no-action letter issued by the SEC Division of Investment Management permitting registered open-end and exchange-traded index-based funds to exceed the limits of a "diversified company," as defined in the Investment Company Act of 1940 (Investment Company Act), without obtaining shareholder approval.

Goodwin Procter LLP
Boston, MA (617-570-1000)

Another Court Grants Summary Judgment to Adviser in Section 36(b) Mutual Fund Excessive Fee Lawsuit (July 8, 2019)

A discussion of a federal district court in Manhattan decision granting summary judgment in favor of a mutual fund's investment adviser in a lawsuit filed pursuant to Section 36(b) of the Investment Company Act.

King & Spalding LLP
Atlanta, GA (404-572-4600)

Increased Interest in Direct Private Placements (July 10, 2019)

A discussion of the direct placement of bonds under Section 4(2) of the Securities Act of 1933 and its use as a strong complement or alternative to traditional offerings of bonds, whether public or under Rule 144A and Regulation S.

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FINRA Clarifies Its Approach to Assessing Extraordinary Cooperation (July 12, 2019)

A discussion of FINRA guidance concerning credit for extraordinary cooperation in the context of enforcement investigations.

Latham & Watkins LLP
Los Angeles, CA (213-485-1234)

What Institutional Broker-Dealers Need to Know about Regulation BI (July 8, 2019)

A discussion of new SEC Regulation Best Interest and the fact that its definition of "retail customer" is substantially broader than the FINRA definition. Accordingly, firms that view their business as exclusively institutional under existing definitions may need to consider adopting new policies and procedures.

SEC Imposes $5 Million Penalty on Investment Adviser for Valuation Practices (July 9, 2019)

A discussion of a SEC order that reminds investment advisers that they should take care to ensure that their valuation policies for client assets are tailored to their specific businesses, conform to GAAP and are properly implemented in practice.

McGuireWoods
Richmond, VA (804-775-1000)

Delaware Court Issues Important Decision about Privileged Communications' Ownership in Corporate Transaction (July 3, 2019)

A discussion of a Delaware Chancery Court decision, *Shareholder Representative Services LLC v. RSI Holdco, LLC*, that should comfort selling companies who do not delete privileged communications from their servers and computers before transferring those to buyers but want to prohibit those buyers from accessing the privileged communications.

Morgan, Lewis & Bockius LLP
Philadelphia, PA (215-963-5000)

SEC Form CRS Roadmap (June 27, 2019)

A discussion of the new SEC Form CRS customer or client relationship summary and how to start navigating its operational challenges.

Morrison & Foerster LLP
New York, NY (212-468-8000)

Non-GAAP Financial Measures for REITS (July 2019)

A discussion of the importance for REITS, including their boards of directors, management teams and advisors, to understand the SEC's rules, regulations and latest guidance with respect to non-GAAP financial measures.

Porter Wright Morris & Arthur LLP
Washington, DC (202-778-3000)

Internal Investigations: Their Risks and Benefits (July, 2019)

A discussion of the purposes of internal investigations, the benefits of conducting them, and the potential risks to the company of a poor investigation.

Proskauer Rose LLP
New York, NY (212-969-3000)

SEC Adopts Amendments to Auditor Independence Rules Addressing Lending Relationships (July 2, 2019)

A discussion of the SEC's adoption of amendments to Regulation S-X, which sets forth auditor independence standards, changing the analysis of whether an audit firm is independent if it has a lending relationship with certain shareholders of

the audit client at any time during an audit or other professional engagement period.

Shearman & Sterling LLP
New York, NY (212-848-4000)

Caremark Unfrozen: Delaware Court Revisits Oversight Claims (July 1, 2019)

A discussion of the Delaware Supreme Court decision in *Marchand v. Barnhill*, finding that the plaintiff sufficiently pled facts demonstrating that a board had not satisfied its duty to exercise oversight over the corporation, which was an act of bad faith in breach of the duty of loyalty.

Sidley Austin LLP
Chicago, IL (312-853-7000)

Massachusetts Securities Division Proposes Uniform Fiduciary Standard (July 2, 2019)

A discussion of the proposal by the Massachusetts Securities Division of a state regulation to apply a fiduciary standard of conduct to broker-dealers, agents, investment advisers, and investment adviser representatives when they advise their customers.

Sullivan & Cromwell LLP
New York, NY (212-588-4000)

2019 Proxy Season Preview: Part 1 (July 12, 2019)

A review of Rule 14a-8 shareholder proposals submitted and/or voted on at annual meetings of US companies of the S&P Composite 1500 at annual meetings held on or before June 30, 2019.

Wachtell, Lipton, Rosen & Katz
New York, NY (212-403-1000)

Spotlight on Boards (June 27, 2019)

A discussion of the expectations for boards of directors.

Rulemaking Petition Requests More Restrictive SEC Buyback Rule (July 9, 2019)

A discussion of a rulemaking petition submitted to the SEC by a group of 19 organizations, including the AFL-CIO and Public Citizen, seeking elimination of the existing SEC safe harbor protecting public companies from liability for market manipulation under the Securities Exchange Act of 1934 for compliant stock repurchases

Willkie Farr & Gallagher LLP
New York, NY (212-728-8000)

Walmart Pays $282 Million Long-Running FCPA Investigation (June 26, 2019)

A discussion of Walmart Inc.'s settlement with the SEC and Department of Justice of a long-running corruption investigation into violations of the Foreign Corrupt Practices Act.

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