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#MeToo Litigation: The Changing Landscape

In light of the current focus on #MeToo issues across a wide range of industries, the rise in related litigation should come as no surprise. Notably, however, the statistics also reveal a recent shift in the character of lawsuits in this area. Plaintiffs increasingly appear to be targeting an expanded group of defendants, including public companies, senior management and corporate boards in connection with #MeToo-related litigation.

Indeed, in the last year alone, plaintiff shareholders filed approximately 15-20 derivative and securities class actions based on underlying allegations concerning executives' and directors' response (or lack thereof) to sexual harassment claims within public companies, and the trend into 2019 shows no sign of abating.

With increased and fact-specific litigation in this area, courts have been tasked with reviewing harassment-related shareholder litigation with more frequency, and the results have not been uniform. An understanding of the nature and focus of these lawsuits, as well as the evolving legal landscape, can assist public companies, their executives and board members in determining how best to manage litigation risk.

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Shareholder Derivative Claims

Investors often invoke the age-old derivative action device to assert claims purportedly on behalf of a corporation against officers, directors or other insiders, for alleged harm to the corporation. Derivative complaints based on workplace harassment have included claims of inappropriate physical contact and relationships, verbal abuse, gender discrimination and a hostile work environment based on a "boys club" culture, and assert that senior management and the board of directors, among other things, may have:

- failed to establish and implement appropriate controls to prevent the misconduct;
- failed to monitor appropriately the business and properly investigate red flags;
- willfully ignored misconduct and allowed a hostile culture to persist;
- failed to sanction misconduct;
- affirmatively condoned misconduct by settling lawsuits;
- approved severance or other payment to wrongdoers; or
- minimized exposure or assured the public that nothing was wrong.

On the basis of these claims, shareholders' allegations include that senior management and directors purportedly breached the fiduciary duties of loyalty, due care and good faith, were unjustly enriched and committed corporate waste. See, e.g., *N. Cal. Pipe Trades Pension Plan v. Hennessey*, No. 19-CIV-00149 (Cal. Sup. Ct. Jan. 9, 2019); *Shabbouei v. Potdevin*, No. 2018-0847-JRS (Del. Ch. Nov. 28, 2018); *Willoughby v. Caporella*, No. 1:18-cv-01739-UNA (D. Del. Nov. 2, 2018); *Stein v. Knight*, No. 18CV38553 (Or. Cir. Ct. Aug. 31, 2018).

> One thing is certain, this brand of event-driven shareholder litigation likely is here to stay, and potential SEC involvement may not be far behind.

These shareholder derivative lawsuits generally follow press reports of

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alleged workplace harassment at the company, in what is best characterized as a new flavor of event-driven litigation. See, e.g., *N. Cal. Pipe Trades Pension Plan v. Hennessey*, No. 19-CIV-00149 (Cal. Sup. Ct. Jan. 9, 2019); *Willoughby v. Caporella*, No. 1:18-cv-01739-UNA (D. Del. Nov. 2, 2018); *Stein v. Knight*, No. 18CV38553 (Or. Cir. Ct. Aug. 31, 2018); *DiNapoli v. Wynn*, No. A-18-770013-B (Nev. Dist. Ct. Feb. 22, 2018).

Before initiating a lawsuit, derivative plaintiffs in #MeToo litigation often attempt to bypass the procedural hurdle of making a demand on a company's board of directors to take action. Historically, however, plaintiffs in these cases have encountered difficulty pleading with particularity that a pre-suit demand would be futile. See, e.g., *In re Am. Apparel Inc., S'holder Derivative Litig.*, No. CV 10-06576 MMM (RC), 2012 WL 9506072 (C.D. Cal. July 31, 2012) (Skadden attorneys represented defendants in this action); *White v. Panic*, 783 A.2d 543 (Del. 2001); *Zucker v. Andreessen*, C.A. No. 6014-VPN, 2012 WL 2366448 (Del. Ch. June 21, 2012).

Nonetheless, dismissal is not necessarily a foregone conclusion in derivative suits filed on the basis of alleged sexual misconduct. For example, a recent Nevada decision denied a motion to dismiss a derivative action on demand futility grounds, finding the complaint sufficiently alleged, among other things, that the board knowingly failed to take action in the face of allegedly corroborated reports of sexual harassment at the company. *In re Wynn Resorts, Derivative Litig.*, No. A-18-769630-B (Nev. Dist. Ct. Sept. 4, 2018). In addition, another purported derivative action was settled—even before the filing of a single brief—for tens of millions of dollars and the commitment to establish corporate governance therapeutics.

Securities Class Actions

Running parallel with derivative claims, another increasingly common litigation tactic is for shareholders to allege similar underlying misconduct as a predicate for securities fraud class actions under Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. While theories differ, the mainstay of plaintiffs' arguments is that an alleged material misstatement or omission concerning sexual harassment or the workplace environment purportedly rendered an issuer's statement false or misleading.

In the context of underlying sexual misconduct allegations, investors' securities fraud claims typically concern public statements issued by a company with respect to corporate values, integrity, and adherence to ethical standards and internal policies, juxtaposed with executives' and directors' alleged knowledge of behavior and practices within the company that contradict those corporate policies.

Plaintiffs generally claim that the stock price declined as a result of misconduct allegations becoming public, which often occurs, as with derivative claims, when press reports disclose the underlying conduct. *See, e.g.*, *Reiner v. Teladoc Health, Inc.*, No. 1:18-cv-11603 (S.D.N.Y. Dec. 12, 2018); *Lantz v. CBS Corp.*, No. 1:18-cv-08978 (S.D.N.Y. Oct. 1, 2018); *Danker v. Papa John's Int'l*, No. 1:18-cv-07927 (S.D.N.Y. Aug. 30, 2018); *Luczak v. Nat'l Beverage Corp.*, No. 18-cv-61631-KMM (S.D. Fla. July 17, 2018).

Plaintiffs must clear an exacting pleading bar to pursue claims predicated on Rule 10b-5 liability. Specifically, Rule 10b-5 claims are subject to heightened pleading requirements under the Private Securities Litigation Reform Act and Federal Rule of Civil Procedure 9(b). Often, these claims are met with challenges to the sufficiency of the pleading, particularly in instances where the claims target "soft" representations about corporate culture, which may include arguments that:

- codes of conduct or public statements concerning corporate culture are merely immaterial aspirational statements or "puffery";
- a duty to disclose the alleged misconduct does not exist;
- the alleged facts fail to support a strong inference that the defendants acted with an intent to mislead investors;
- statements about ethical conduct did not alter the "total mix" of information available to stockholders in their decision-making; and
- the stock price declined due to factors other than a revelation that statements about ethical corporate conduct were false.

However, as courts have been tasked with reviewing harassment-related securities claims with more frequency, the rulings have not been uniform. A comparison of recent decisions on motions to dismiss demonstrates the point.

A 2016 decision, *Lopez v. CTPartners Executive Search Inc.*, 173 F. Supp. 3d 12 (S.D.N.Y. 2016), squarely found that certain statements—including statements that touted an inclusive and positive working environment, the promotion of honest and ethical conduct, and a transparent and objective compensation structure—were "immaterial puffery" because a reasonable investor would not rely on

such general statements as a "guarantee" of particular facts.

Similarly, in 2017, in *Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co.*, 845 F.3d 1268 (9th Cir. 2017), the Ninth Circuit found statements in a code of conduct to be "inherently aspirational." At the end of 2018, however, in *In re Signet Jewelers Ltd. Securities Litigation*, No. 16 Civ. 6728, 2018 WL 6167889 (CM) (S.D.N.Y. Nov. 26, 2018), the court denied a motion to dismiss, finding that representations contained in a code of conduct, "which state, *inter alia*, that the company 'bases…decisions solely on a person's [merit and]'…has '[c]onfidential and anonymous mechanisms for reporting concerns'…and that '[t]hose who violate the standards in this Code will be subject to disciplinary action'…are directly contravened by allegations in the [complaint]…." As a result, the court, describing the case as "a garden variety securities fraud suit," found that certain representations were actionable.

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SEC Involvement

Corporate public statements in the wake of sexual misconduct allegations also could result in a Securities and Exchange Commission (SEC) investigation or enforcement action based on the purported failure to disclose material information to investors. Companies should be mindful of the risk that alleged public misstatements concerning corporate culture, and the existence and adherence to company policies concerning workplace behavior and inclusion, could give rise to such enforcement actions if and when allegations of sexual misconduct are revealed.

Moreover, in some instances, private plaintiffs may support a securities fraud material omission claim on the basis of a failure to disclose SEC-required information. For example, Item 303 of Regulation S-K requires a company to "[d]escribe 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."

In the current environment, and to the extent that public revelations of sexual misconduct in the corporate context continue to increase and companies experience unfavorable consequences as a result, the application of this regulation may be tested in future cases.

Conclusion

Derivative claims and securities class actions that have followed exposure of underlying workplace harassment allegations at public companies now are pending in state and federal courts across the country. The question therefore, is not whether more cases will follow—they will—but rather how courts will rule in these cases. With many pending motions to dismiss, seemingly settled law in this area may further develop or shift, as recent decisions demonstrate. These outcomes will impact plaintiffs' appetite for filing, the nature of the claims they bring and the best posture for public companies facing this potential litigation risk. One thing is certain, this brand of event-driven shareholder litigation likely is here to stay, and potential SEC involvement may not be far behind.

In the face of this uncertainty, companies will be better positioned if they have strong, clear and practical protocols and policies addressing sexual misconduct, accompanied by training, and a firm grasp of ever-changing local laws and requirements in this area. Careful consideration should be given to public statements about corporate culture and compliance with policies and procedures. Moreover, a thoughtful and sensitive approach should be taken with respect to the board's role, including the gender composition of the board and senior management, and companies should consider whether a proactive internal investigation to identify and address any potential sexual misconduct issues would be productive.