

#MeToo Movement: Legal Landscape and Director Oversight Considerations

Mutual Fund Directors Forum

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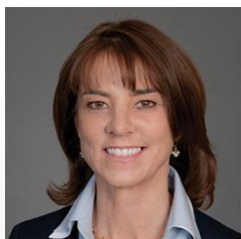


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Speakers



[Deborah Birnbach](#) is partner in Goodwin's Securities Litigation + White Collar Defense Group and co-chair of the firm's M+A / Corporate Governance Practice. She concentrates in the areas of securities litigation, including class action defense; SEC, regulatory and internal investigations; M+A-related litigation; stockholder disputes; fiduciary duty claims; proxy contests; founder and partnership disputes; and private equity. Her securities and shareholder litigation practice is national in scope and involves representing investment managers, issuers and their directors and officers in securities and corporate governance matters across the country. In addition to engaging in active litigation, Ms. Birnbach counsels clients and their boards in managing and avoiding litigation risk, including through arbitration, mediation and other alternative dispute resolution methods. Ms. Birnbach's clients include public and private healthcare and life sciences companies, technology companies, and financial services companies, their boards and officers, and private equity firms and their partners.



[Jennifer Fay](#) is a partner in Goodwin's Labor + Employment practice and a member of the firm's Executive Committee. She is also a founding member of the firm's Trade Secrets + Restrictive Covenants practice. Ms. Fay focuses her employment law practice on servicing the firm's technology, life sciences, private equity/venture capitalist and financial services clients, as counselor, a litigator and an employment law compliance expert. She has developed a particular expertise in connection with CEO and other executive transitions, complex workplace investigations and the development and implementation of proactive human resources strategies, including interactive workplace training. Ms. Fay dedicates much of her practice to investigations related to alleged discrimination/harassment, ethics and policy violations, founders' disputes and whistleblower claims.



[Paul Delligatti](#) is a partner in Goodwin's Financial Industry and Investment Management practices, where he focuses on representing investment advisers, registered investment companies and their independent directors and other pooled investment vehicles. His investment company clients include open-end and closed-end funds, multi-class funds, funds of funds and funds utilizing manager of managers structures.

Agenda

- Harassment in the #MeToo Era
- Operating Companies versus Externally Managed Funds
- Securities Implications for Operating Companies, including Fund Service Providers
- Registered Fund Director Oversight Considerations

Harassment in the #MeToo Era



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Workplace Harassment in the #MeToo Era

- Anti-Harassment Law in the “#MeToo” era
 - Definitions
 - Reporting
 - Potential Liability
 - The Roles of Senior Management and the Board

What is Unlawful Harassment?

- Harassment claims are generally divided into two categories:
 - Quid pro quo harassment
 - Hostile work environment harassment

These categories stem from the case law interpreting harassment claims. They are helpful in understanding what behavior constitutes unlawful harassment, but there is often overlap between the categories.

The terms of each category is less important than the ultimate question of whether the conduct has altered the terms and conditions of employment sufficiently to be attributable to the employer and unlawful.

Sexual Harassment – Quid Pro Quo

- Sexual harassment is defined as unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature when:
 - Submission to such conduct is made either explicitly or implicitly a term or condition of an individual's employment;
 - Submission to or rejection of such conduct is used as the basis for employment decisions affecting an individual.
- The elements of quid pro quo harassment are:
 - Sexual advances that were unwelcome
 - Harassment that was sexually motivated by the harasser
 - The employee's reaction to the advances negatively affected tangible aspects of their employment (such as compensation, promotion or hiring)
 - The harassment is attributable to the employer because the harasser may have a direct impact on the tangible aspects of employment

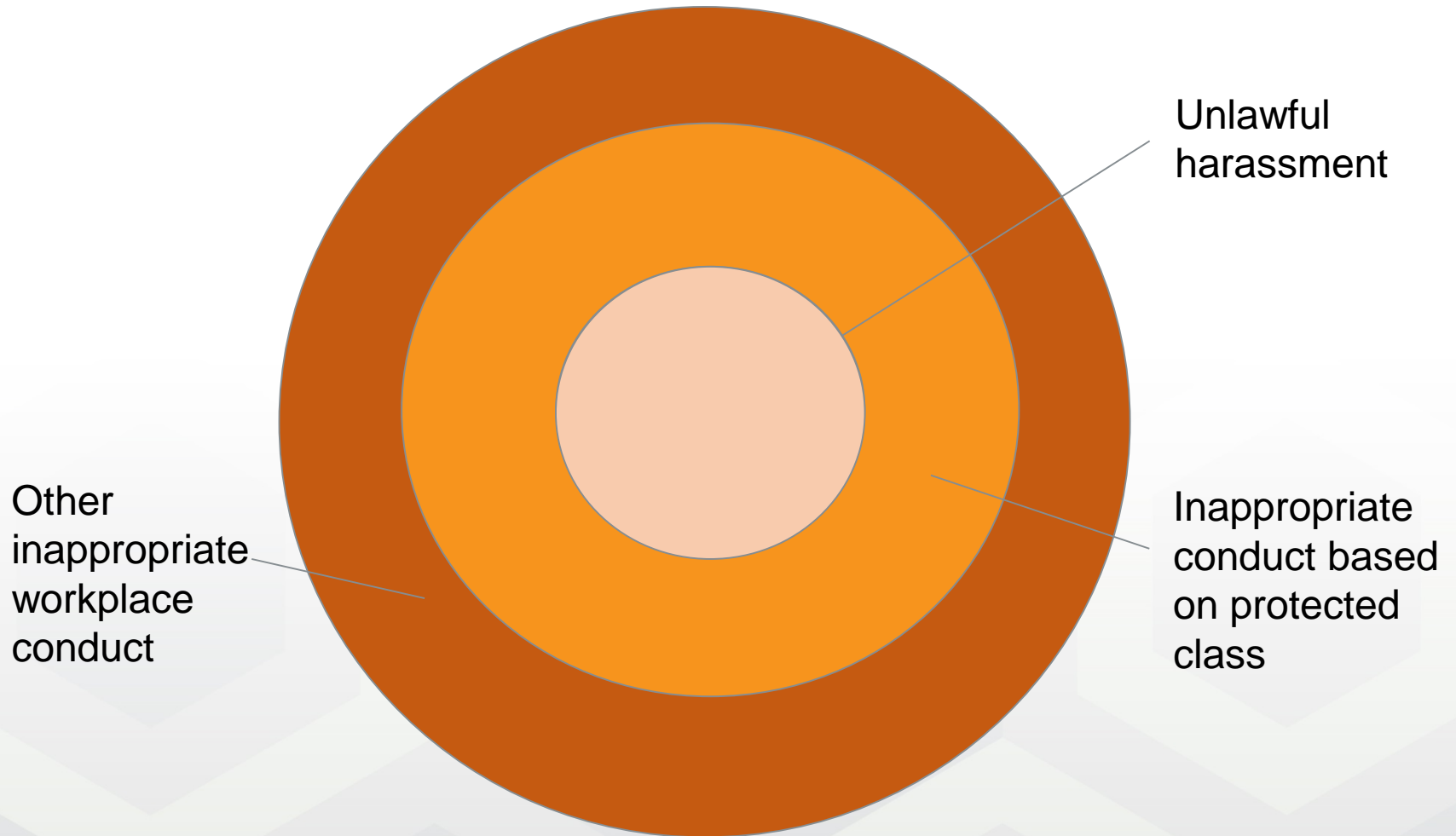
Hostile Work Environment Harassment

- Hostile work environment harassment is more widely alleged than quid pro quo harassment and is more subjective. It does not require tangible job consequences or financial injury.
- To rise to the level of hostile work environment harassment, the conduct must be sufficiently severe or pervasive to alter the conditions of employment and create an abusive working environment.

Hostile Work Environment Harassment: Two Part Test

- Severe or pervasive enough to change the conditions of employment and create an abusive environment, judged by both:
 - An objective standard (in other words, any reasonable person would find the conduct abusive); and
 - A subjective standard (in other words, the employee in question found the conduct abusive).
- Factors considered include the frequency of the conduct, the severity of the conduct, whether the conduct is physically threatening or humiliating or merely an offensive comment, and whether the conduct unreasonably interfered with an employee's work performance.

Understanding the Levels of Prohibited Workplace Conduct



Anti-Harassment: Beyond Sexual Harassment

- It is also legally impermissible to engage in verbal or physical conduct that denigrates or shows hostility or aversion toward an individual because of his or her race, color, gender, religion, sexual orientation, age, national origin, disability, or other protected category (or that of the individual's relatives, friends, or associates) that:
 - 1) has the purpose or effect of creating an intimidating, hostile, humiliating, or offensive working environment;
 - 2) has the purpose or effect of unreasonably interfering with an individual's work performance; or
 - 3) otherwise adversely affects an individual's employment opportunities.

Anti-Harassment: Liability

- An employer can be held strictly liable for unlawful harassment in the workplace by a manager/supervisor.
- The employer may also be held liable if it does not promptly and appropriately investigate and address a complaint of unlawful harassment.
- In some circumstances, individuals may be held personally liable for unlawful harassment.

Anti-Harassment in the #MeToo Era

- The law has not changed but many other things have, like:
 - Awareness
 - Attitudes
 - Tolerance
 - Public relations risks

Anti-Harassment in the #MeToo Era

- What are companies doing to mitigate legal and business risks, and to have more productive workplaces?
 - Proactive
 - State of the art policies
 - Processes, including a defined approach to reporting and responding
 - EFFECTIVE Training
 - Anti-Harassment (especially managers)
 - Interactive training, consider different formats and different levels within the organization
 - Avoid “check the box” programs
 - Unconscious bias

Anti-Harassment in the #MeToo Era

- What are companies doing to mitigate legal and business risks, and to have more productive workplaces?
 - Reactive
 - Understanding the response obligation
 - Having a team of HR/legal/communications experts; experienced and well-trained professionals, ready to jump in.
 - Keep things nimble but have a solid structure.

Anti-Harassment in the #MeToo Era

- Guidance for Senior Management and boards
 - Assess the Team
 - Ensure HR departments are trusted and capable
 - Ensure front line managers are approachable and know how to respond to a concern
 - Ensure employees who become aware of potential harassment escalates to HR
 - Ensure HR consults with Legal early and often.
 - Talk at the Top
 - Talk the talk and walk the walk
 - Responsibility/Accountability

OPERATING COMPANIES VERSUS EXTERNALLY MANAGED FUNDS



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Contextual Distinctions: Ordinary Operating Company versus Investment Company Setting

- Operating Company:
 - Directors, officers and employees of the operating company may be the subject of harassment allegations, which exposes the company, the individuals and the Board to potential liability
- Registered Funds:
 - External service providers carry out the vast majority of the day-to-day management and operation of the Funds
 - Limited exceptions
 - Board role in selecting and overseeing external service providers
 - Primary service providers include investment adviser and any investment sub-advisers
 - Other service providers: administrator (may be same entity as adviser), accountant, transfer agent, principal underwriter, custodian, outside counsel, etc.

SECURITIES LAW IMPLICATIONS FOR OPERATING COMPANIES, INCLUDING FUND SERVICE PROVIDERS



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Potential Liability and Disclosure Considerations

- Potential claims under federal securities laws relating to disclosure obligations
 - Exposure for companies, boards and individuals
 - Boards have also been subject to state law claims governing fiduciary duties
- Disclosure Considerations: whether and when to disclose an investigation relating to unlawful workplace harassment
 - Practical considerations
 - Type of allegations and historical context
 - Rules and regulations governing disclosure obligations
 - Regulation S-K, Item 103 (Legal Proceedings)
 - Regulation S-K, Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A))
 - Accounting Standards Codification (ASC) 450 (Loss Contingencies)

Recent Cases Involving Sexual Harassment Investigations

- Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co.
- City of Monroe Employees' Retirement System v. Rupert Murdoch
- Wynn Cases
 - Class Action
 - Ferris v. Stephen A. Wynn, et al.
 - Derivative Actions
 - Norfolk County Retirement System v. Stephen A. Wynn, et al.
 - Operating Engineers Construction Industry and Miscellaneous Pension Fund v. Stephen A. Wynn, et al.
 - Boynton Beach Municipal Firefighters' Pension Trust Fund and the Fireman's Retirement System of St. Louis v. Stephen A. Wynn, et al.

REGISTERED FUND DIRECTOR OVERSIGHT CONSIDERATIONS



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Defining the Fund Board's Responsibilities

- Responsibilities: Substantial responsibility under Investment Company Act of 1940 for ensuring that interests of shareholders are adequately protected and that issues involving a conflict of interest between the fund and an affiliated service provider are resolved in a fair and equitable manner
 - State law fiduciary duties of care and loyalty
 - Role of Independent Directors
 - Critical role in selecting service providers
- External Model: Investment advisers and other service providers generally have their own board oversight and governance structure
 - Defining the role of the Fund Board in externally managed / operated context
 - Direct and indirect interests of the Fund Board
 - Matters to consider in exercising oversight function
 - Special situations
 - Disclosure issues

Direct and Indirect Interests of Fund Boards

- Primary focus is on protecting interests of the Fund and its shareholders
 - Oversight of performance
 - Operational risks of the adviser that could impact performance
 - Adviser and sub-adviser versus other service providers
- Ability of the service provider to carry out its duties and responsibilities
 - Impact on personnel → consider level of involvement with Fund
 - Ability to attract and retain qualified professionals
 - Hostile environment could impair overall quality of services
- Reputational considerations
 - Consider impact on the Fund, including potential for redemptions
 - Extent to which issues could impact other Funds in the same complex
 - Consistency with Fund mandate (e.g., Environmental, Social & Governance (ESG) Focused Funds)
- Other consequences for service provider, including financial impact
- “Direct” reports and Interested Directors

Fund Board Oversight Considerations

- Formal inquiries of the adviser and other key service providers
 - Initial and annual contract review process
 - Adviser (administrator) oversight of sub-advisers and other Fund service providers
 - Scope of inquiries – policies, processes, training, etc.
 - Confidentiality considerations relating to allegations and investigations
- On-going informal dialogue with senior management
 - Setting expectations and mutual understanding with senior management
- Information regarding inquiries that adviser is receiving from clients and Fund shareholders
- Understanding the impact and viable options for the Fund
- Fund Board diversity

Special Situations for Fund Boards

- Fund Officers and Interested Directors
 - Considerations where the allegations relate to a Fund officer or an Interested Director of the Fund
 - Consider nature of the officer's role (e.g., Chief Compliance Officer versus state law officers) and position with adviser
- Other Fund Service Providers
 - Considerations in the context of unaffiliated service providers
- ESG Funds

Fund Disclosure Issues

- Harassment at the service provider-level typically would not result in disclosure obligations for the Fund
- Legal Proceedings
 - Form N-1A Item 10(a)(3) requires disclosure of any material pending legal proceedings to which the Fund or the Fund's investment adviser or principal underwriter is a party
 - Materiality considerations
 - Coordinating with disclosure by the adviser
- Changes in Personnel, including Portfolio Managers
- Disclosure Regarding Basis for Fund Board's Approval of Investment Advisory and Sub-Advisory Agreements
 - Policies and procedures
 - Consideration of impact of specific matter on the ability of an adviser or sub-adviser to provide services to the Fund

QUESTIONS?



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