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Dispute over Compulsory Arbitration Agreements in Employment Cases Widens

By Pablo Orozco

Employers take note: A battle is brewing over the legality of class action waivers and compulsory arbitration agreements in the employment context. Specifically, the question is whether arbitration agreements that preclude all forms of collective or class actions are unenforceable because they are illegal under the National Labor Relations Act (NLRA).

The battle lines are drawn. On one side stand the U.S. Courts of Appeal for the Second, Fifth and Eighth Circuits with rulings that favor employers (Pro-Employer Rulings). *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (2nd Cir. 2013); *D.R. Horton, Inc. v. N.L.R.B.*, 737 F.3d 344 (7th Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050 (8th Cir. 2013).

On the other side stand the U.S. Courts of Appeal for the Seventh and Ninth Circuits, with recent rulings that favor employees (Pro-Employee Rulings). *Lewis v. Epic Sys. Corp.*, 823 F.3d 1147 (7th Cir. 2016); *Morris v. Ernst & Young, LLP*, Case No. 13-16599, 2016 WL 4433080 (9th Cir. Aug. 22, 2016). The Seventh Circuit's *Lewis* case involved allegations that Epic Systems Corporation, a company that offers software

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Seven Myths About Dealing with Activist Investors — and the Realities

By Charles Nathan

One of the oldest adages in any conflict situation is to know your enemy. This is certainly true for corporate managers and counsel whose companies become the target of an activist investor. One recurring difficulty is to distinguish between the myths that surround activist investing, and the reality. Far too often, a company's attitude toward and response to an activist investor is premised on the myths. Those reactions are at best misguided and at worst a prescription for disaster. The purpose of this article is to debunk the myths and articulate the reality of activist investing.

Myth 1: Activism Is All About the Short-Term. Frequently, the phrases "short-term" and "long-term" are used to refer to the period of time that activists are reputed to maintain their ownership stake in a company. The implication (and frequently outright assertion) is that because activists are mere short-term holders, they are not entitled to the same voice in a company's governance as obviously more virtuous and deserving long-term holders.

There are two fatal flaws in this reasoning. First, many studies have demonstrated that, on average, activist investors maintain their position for a matter of years, not months. Second, there is no rational reason to think that long-term shareholders have special insights into or understanding of corporate decisions and strategy. Indeed, if the long-term holder is, as increasingly is the case, an index fund, then by definition its investment has nothing to do with a company's strategy or business decisions, and the investment manager has no basis to claim any knowledge or insights.

Confusingly, the mythology of activist investing also conflates the putative holding period of the activist with the implementation period for the program advocated by the activist investor. Castigating a corporate strategy as short-term, rather than long-term, simply misses the point. The issue is not the duration of time required for implementation, but rather the value creation potential of

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Activist Investors

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the program. No rational investor, or company manager, would (one would hope) advocate adoption of a longer-term strategy over a shorter one, if the shorter one had a higher value creation opportunity.

The confusing use of the terms short-term and long-term lead directly to the second major myth of the anti-activist literature.

Myth 2: Long-Term Is Inherently Good and Short-Term Is Inherently Bad. There is nothing innately virtuous about the long term, whether it is the duration of a portfolio position or a company strategy, nor is there anything innately evil about a short-term holding period or implementation period for an alternative company strategy. It is ludicrous to claim (or worse, believe) that anything long-term is by its very nature good, while anything short-term is by its very nature bad.

Notwithstanding this obvious truism, anti-activist mythology consistently assumes short-term is bad and long-term is good. Repetition of these baseless assumptions may have its purposes, but describing reality is not one of them. The reality, of course, is that there are both good and bad short-term strategies, just as there are good and bad long-term ones. The relevant issue is determining which strategy will create more net present value for the company and its constituencies, not which one will take longer or shorter to implement.

Myth 3: Activist Investors Possess "Unprecedented Influence" and "Immense Financial Power." The truth, of course, is that as large as some activist funds may be, they are utterly dwarfed by the size of the equity investor universe. A few activist funds may exceed $10 billion and total activist funds may approach $150 billion in the aggregate, but activists are hardly a blip when compared with the $55-$68 trillion international equity markets. Another way to measure the relative insignificance of activist investors is to compare the size of their funds (say, $10-$15 billion for the largest) to the leading asset management firms in the U.S., starting with BlackRock Inc. ($4.8 trillion under management), Vanguard Group Inc. ($3.1 trillion), State Street Corp. ($2.4 trillion) and Fidelity (a mere $2 trillion).

Activist investors simply do not have the financial resources or desire to own a large amount of the stock of any company. It is rare that an activist's holding in a company exceeds 10%, and many are well below 5%. While activist holdings are not insignificant and surely entitle the activist to be heard, activists simply do not have the power or share ownership to compel a company to take any action — good, bad or indifferent.

Myth 4: Activists Use "Unscrupulous" Tactics. Activists are not alchemists who nefariously transmute relatively small share ownership positions into the power to compel companies to adopt wrong-headed policies rightly opposed by their boards and managers. Rather, activists are ultimately dependent on the support of at least a majority of a company's other shareholders to achieve their goal of changing some aspect of a company's business or strategy. The activist investor's typical game plan is simple and consistent.

Identify a company that is undervalued in the market because it is not fully realizing its potential.

Propose a solution to management that the activist believes will unlock the full value of the company.

If management is unwilling to work with the activist to improve the company's operations or strategy, bring the proposed plan to the company's shareholders, who own the company and have the final say on company policy though their ability to vote at shareholder meetings.

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Navigating Ethics Minefields As In-House Counsel

By Tamara Kurtzman

It is a well-established principle that in the case of corporate counsel — whether in-house or not — an attorney's allegiance is owed to the organization itself. That is, the client is the corporation alone and not any of the individual constituents associated with that entity. The difficulty arises, however, in that although a corporation is considered to be a "person" under the law, this is nonetheless a legal fiction — unlike a true person, it cannot act of its own accord. Rather, corporations and other entities may, by definition, act only through their agents, who may on occasion act in ways that are not always in furtherance of the best interests of the corporate client.

In the case of in-house counsel, the complexities of corporate representation are further complicated in light of the dominance of the law firm model reflected in the Model Rules of Professional Conduct (the Rules), which most U.S. jurisdictions have adopted in some form. Despite the fact that the Rules are often far more compatible with traditional private practice models and rather ill-suited to address in-house practice, they are intended to cover all attorneys, regardless of where they practice. There is no separate code of conduct for in-house attorneys. The result is that in-house attorneys and legal departments are left attempting to figure out how to adapt inapt Rules to a corporate environment with little or no guidance from bar committees.

When an attorney works as in-house counsel for a company for some time, it is neither unusual nor surprising that a type of cultural immersion develops whereby the attorneys comes to identify deeply with the organization that is both the employer and client. This identification, however, poses significant challenges to an attorney's ability to fulfill the ethical obligations of his or her profession.

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One of the duties so implicated is that of independent judgment. This duty of independence manifests itself in a number of different ways throughout the Rules. For example, under the Rules, all attorneys are required to provide candid and independent advice to their clients — regardless of how unwelcomed that advice may be by the client. Indeed, it is often the role of an attorney to provide a client with advice that may ultimately delay or otherwise frustrate certain business objectives. Unlike their private-practice counterparts, however, in-house counsel are not simply attorneys — they are also employees and often hold other positions within their employer organization. Given the multiple roles often played by in-house counsel, ethical issues surrounding independence develop in a host of circumstances.

Attorneys As Board Members

Amidst the increasingly risky regulatory environment facing business today, it is not surprising that more and more corporations seek to invite attorneys to join their boards of directors. Indeed, since 2008, the number of U.S. publicly traded companies with lawyers on their boards has increased by roughly 20% and studies show that having an attorney-directors positively impacts a company's litigation management and alignment of executive compensation with shareholder interests. Notwithstanding the potential benefits of having lawyer-directors, boards and attorneys themselves should proceed with caution when considering a lawyer that provides legal services to the corporation, especially when that attorney is in-house counsel to the corporation.

While no explicit prohibition exists barring an attorney from serving as a member of his or her client's board of directors, independence once again becomes an issue, since an attorney who serves both as attorney and director of a corporation is not only an employee of the corporation, but also has become both a client and attorney. This means that the lawyer may be called on to advise the corporation in matters involving actions of the directors. If there is a material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as director.

Similarly, the presence of an attorney on the board of directors increases the risk that communications with that attorney will not be protected by the attorney-client privilege. It is therefore critical that attorney-directors make a clear distinction as to when they are acting or advising in their capacity as a board member and when they are acting as legal counsel. Lawyer-directors should also be aware that their status as a board member for a client could be construed to make them a "control person" under Section 20(a) of the Securities Exchange Act of 1934. As a "control person," an attorney-director may be held jointly and severally liable for the actions of the corporation's employees and agents, based on the premise that, as a director, the attorney-director had ultimate control over such actions.

Conflicts Relating to Joint Representation

Likewise, although in-house counsel has traditionally had a single client — his or her employer — in-house attorneys are increasingly becoming embroiled in impermissible conflicts involving the simultaneous representation of both the company itself and individual constituents of the company, such as officers, directors, or employees. Often this joint representation is quite inadvertent, arising from misunderstandings regarding the lawyer's role in dealing

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with an individual and courts' willingness to find an attorney-client relationship on the basis of the reasonable expectations of the client.

Under Model Rule 1.7, a potentially impermissible conflict of interest exists if representation of a client "may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests." Whenever an attorney represents both an organization and an individual constituent in the same matter, it will nearly always be the case that the representation of one may be "materially limited" by the attorney's responsibilities to the other. This is so even if the organization has agreed to indemnify the constituent, as that individual will often have interests different from those of the organization. While conflicts that arise in joint representation may certainly sometimes be waived upon proper disclosure and consent, not all conflicts are waivable.

Again under Model Rule 1.7, joint representation is lawful only if, in addition to the client's informed consent, the attorney reasonably believes the representation will not be adversely affected. Accordingly, in cases of investigations or litigation, joint representation is often non-consentable when the best interests of one client may reasonably result in taking a position adverse to the other client.

For example, in the case of litigation against both the company and an individually named officer, it might be beneficial for the company to argue that an officer acted beyond the scope of his authority. To allow the joint representation to proceed despite being non-waivable is therefore to risk disqualification. This prospect is especially problematic in the case of in-house counsel since generally, principles of imputation apply to a corporate legal department in precisely the same manner as they do in the context of a traditional law firm. Thus, if one lawyer is disqualified because of a conflict of interest, so too is the entire legal department.

Compensation Pitfalls

Another potential ethical minefield for in-house attorneys is compensation — especially given that compensation structures for in-house attorneys are generally quite different from traditional law firm models built around hourly rates and contingency percentages. Rather, in-house attorneys are generally the salaried employees of their clients. Notably, there is nothing in the Rules expressly prohibiting this structure (indeed, it is akin to what might be considered a flat-fee arrangement in the context of outside counsel). Compensation provided to in-house counsel must nonetheless comport with the Rules relating to fairness of attorney fees and certain restrictions relating to business transactions with clients.

Specifically, Model Rule 1.5 prohibits an attorney from receiving an "unreasonable fee or an unreasonable amount for expenses." Traditionally, this has meant prohibiting either compensation grossly disproportionate to the work performed or the charging of disbursements to which large additional surcharges have been applied. In the case of in-house counsel, an attorney's entire compensation (taking into account any raise, bonus and/or other benefits) must be considered and reviewed under the "unreasonable" standard set forth in Rule 1.5. This evaluation becomes especially important if an attorney receives stock options as part of his or her compensation. Although such options may represent little or no value when originally awarded, if the stock price increases significantly during the exercise period, these options may come to represent substantial value for the attorney holder. In such event, an argument might be made that the total compensation received by the attorney is ultimately too high, and therefore unreasonable (especially if the lawyer also has received a salary in the interim).

The receipt by attorneys of compensation in the form of equity or other business interests is also potentially problematic under Model Rules 1.7 and 1.8. As discussed previously, Model Rule 1.7 applies whenever the lawyer's financial interest in a client is such that it may materially limit the lawyer's representation. In the context of equity compensation, when the lawyer's interest in a client is significant there is the potential that the lawyer's investment interest may differ from the company's long-term interest. Thus for example, in-house counsel who is a large stake-holder in the company may be reluctant to offer advise that, if implemented, may adversely affect the price of the stock — regardless of how legally proper that advice might be. As previously discussed, personal interest conflicts under Rule 1.7 are often consentable, but there may nonetheless be circumstances in which the lawyer is prohibited from advising the company in a particular matter.

Model Rule 1.8 provides that a lawyer shall not enter into a "business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client" unless that the transaction was fair and reasonable to the client. Additionally, Model Rule 1.8 prescribes several requirements with which an attorney must comply if he or she is to enter into a business transaction with a client. For example, the lawyer must disclose the terms of the transaction in writing, give the client an opportunity to seek advice from independent counsel, and obtain the client's written consent to the transaction.

In the context of early-stage companies, lawyers sometimes become principals in the business and may be granted equity interests in lieu of cash payment for legal services. To the extent that an in-house lawyer's receipt of equity-based compensation is merely a component of the general employment relationship and is offered pursuant to a company-wide, long-term incentive plan, the requirements of Model

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What Are 'Commercially Reasonable Efforts' in M&A Transactions?

By Sonja Carlson

Two recent rulings out of the Delaware Court of Chancery have highlighted the importance of clearly defining the terms of pre-closing obligations. In an M&A transaction, it takes significant time to get from a signed letter of intent to a closed deal. Pre-closing obligations, and the level of effort a party is required to exert to meet those obligations, are typically subject to heavy negotiation. While practitioners tend to negotiate according to a sliding scale of efforts standards — "commercially reasonable efforts," for example, require something less than "best efforts" — neither Delaware nor New York courts have articulated tiered efforts standards in such a manner. Furthermore, and what the recent Delaware rulings again underscore, the various formulations do not have precisely defined meanings in common law.

The Delaware Court of Chancery recently shed a ray of light on the efforts clause mire. In a July 14 bench ruling on a motion to dismiss (*WP CMI Representative v. Roche Diagnostics Operations*), Vice Chancellor J. Travis Laster stated that "the inclusion of the word 'reasonable'" in the commercially reasonable efforts standard makes it "an objective standard." On this same point, Laster cited Vice Chancellor Sam Glasscock III's June 24 opinion in *Williams v. Energy Transfer Equity*. By agreeing to use commercially reasonable efforts, Glasscock wrote, the plaintiff "necessarily submitted itself to an objective standard — that is, it bound itself to do those things objectively reasonable to produce the desired [tax opinion], in the context of the agreement reached by the parties."

If the efforts clause situation still looks muddy, that's because it is. Laster offered up one additional sliver of light, illustrating the type of behavior that may run afoul of a commercially reasonable efforts standard. He stated that if the obligated party does something "that wasn't originally contemplated and which has the effect of causing the milestone not to be hit," it is "reasonably conceivable" that the change in behavior was contrary to such party's obligation to use commercially reasonable efforts.

Interestingly, New York courts have employed the concept of objectivity in a different fashion. In Delaware, contractual best efforts clauses are enforceable as a rule; in New York, the law is unsettled as to how — or even if — an efforts clause is to be enforced in the absence of "objective criteria against which a party's efforts can be measured" (*Timberline Development v. Kronman* [2000]). In support of this position, New York courts have suggested that when parties fail to contract for a clear set of guidelines against which to measure the contracted-for efforts, then courts can enforce an efforts clause only when external circumstances impart sufficient certainty to the meaning of the efforts clause, thereby serving as gap fillers. There is merit in this position, given that courts are wary of rewriting contracts or imposing meanings *ex post facto* on the terms of negotiated contracts.

More broadly, a survey of case law in Delaware and New York — two of the most popularly contracted-for jurisdictions in M&A transactions— demonstrates that little is clear when it comes to effort clause analysis. There are not generally bright-line or uniform requirements, and when parties do not define efforts terms, there is little certainty in how courts will interpret parties' obligations.

Here is a quick and dirty summary of Delaware and New York case law.

Delaware

In *Williams*, Glasscock began his analysis by observing that the term "commercially reasonable efforts" was not defined in the parties' merger agreement, and that it "is not addressed with particular coherence in our case law." Earlier cases have noted that Delaware law does not define the "precise contours" of the best efforts standard. Hence, when analyzing a party's obligations under an efforts clause, the court's inquiry is necessarily fact-intensive.

Delaware courts have tended to use "reasonable best efforts" and "best efforts" interchangeably. This is at odds with the recent rulings in *WP CMI* and *Williams*, in which the court clearly equates "reasonable" with "objective." Nonetheless, a brief survey of case law confirms that Delaware courts "do not define the precise contours" of a party's duty under efforts clauses (*Crum & Crum Enterprises v. NDC of California* [2010]). The leading Delaware case, *Hexion Specialty Chemicals v. Huntsman* (2008), concerns a reasonable best efforts clause. The *Hexion* court found that the plaintiff failed to use reasonable best efforts to consummate the merger and failed to act in good faith. In reaching this holding, however, both the plaintiff and the court cited and applied best efforts case law.

The plaintiff's counterargument cited the seminal New York case *Bloor v. Falstaff Brewing* (1979) — which concerned a best efforts clause — and the *Hexion* court then applied *Bloor's* best efforts standard in analyzing the plaintiff's performance under the reasonable best efforts clause. The court noted that while a party need not "spend itself into bankruptcy," it is impermissible for a party to emphasize profits *über alles* without consideration of the other party's interests. A party must make some genuine effort, and must take actions that are "both commercially reasonable and advisable to enhance the likelihood

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of consumat[ing]" the contracted-for objective.

A 2013 bench ruling in *Cooper Tire & Rubber v. Apollo (Mauritius) Holdings* provided some insight into the types of actions that may satisfy a party's obligations under a reasonable best efforts clause. Addressing the limited issue of whether the defendant was in material breach of the parties' merger agreement with respect to its negotiations with a union, the court held that the plaintiff had "failed to demonstrate" that the defendant had not met the reasonable best efforts standard. In finding that the defendant had satisfied that requirement, the court noted that the defendant: 1) took affirmative actions to negotiate with the union; and 2) did not intentionally frustrate the process or act in bad faith.

Perhaps unsurprisingly, Delaware courts have not identified a distinct "commercially reasonable efforts" standard and have tended to use terminology loosely and interchangeably. There is a dearth of case law in which courts have addressed the merits of a breach of commercially reasonable efforts clause claim. In a 2010 case, *WaveDivision Holdings v. Millennium Digital Media Systems*, the court appeared to apply the *Hexion* court's reasonable best efforts criteria in analyzing the defendant's breach of the commercially reasonable efforts clause in the parties' purchase agreement. Interestingly, the *WaveDivision* court did not cite to *Hexion* or any other case in the course of its purely fact-intensive analysis. In holding that the defendant breached its obligations under the commercially reasonable efforts clause, the court employed the phrase "reasonable best efforts" twice and the phrase "commercially reasonable steps" once (thereby invoking *Hexion*), but never once couched its analysis or holding in terms of a distinct commercially reasonable efforts standard.

New York

Quoting the seminal *Bloor* case, the U.S. Court of Appeals for the Second Circuit aptly noted, "New York law interpreting best efforts clauses is 'far from clear.'" Courts have often used terminology interchangeably in analyzing "best efforts," "reasonable efforts" and "reasonable best efforts" clauses, tending to reach decisions without delineating nuanced differences between standards. Delaware's position that "reasonable" imparts inherent objectivity to efforts clause analysis is not echoed in New York case law, which has not tended to differentiate efforts clauses based on the word "reasonable." For example, in interpreting a contract for cable programming, the New York Supreme Court held that "financial difficulty of performance" did not excuse the distributor's performance under either a "best efforts" or a "reasonable best efforts" standard (*Showtime Networks v. Comsat Video Enterprises*).

What precisely is required under a best efforts, reasonable efforts or reasonable best efforts clause is unclear, although case law gives some guidelines. It is clear that a party has the right to give reasonable consideration to its own interests. As stated in the seminal *Bloor* case, however, a party cannot adhere to a "philosophy of emphasizing profit *über alles* without fair consideration of the effect on [the other party's interests]." The *Bloor* court also stated that a party is not required to "spend itself into bankruptcy." Nonetheless, more recent cases emphasized the lack of clear requirements. In a 2006 case, *Ashokan Water Services v. New Star*, the court stated: "It is still unclear when and how an express 'best efforts' provision is to be enforced in the absence of articulated objective criteria in the agreement, and, particularly, the relationship between 'best efforts' and 'good faith,' 'fair dealing,' and 'reasonable care.'"

The New York courts seem to differentiate "commercially reasonable efforts" clauses from other efforts clauses. Here again, however, there is no settled set of criteria. As with the other clauses, a party is not required "to act against its own business interests," as stated by the court in *MBIA Insurance v. Patriarch Partners VIII* (2013). However, courts have not consistently applied this concept, resulting in surprising and contradictory outcomes. In some cases, such as *MBIA Insurance*, courts have found that financial harm excuses a party's performance under a commercially reasonable efforts clause. In other cases, however, courts have found that financial harm does not excuse performance — and, in the extreme, that bankruptcy may be an acceptable result.

In *Rex Medical v. Angiotech Pharmaceuticals (US)* (2010), the defendant distributor argued that its continued performance under the parties' agreement had become commercially unreasonable (due to financial losses incurred in performance of the agreement and an otherwise worsening financial condition, which could lead the defendant into bankruptcy). The *Rex* court outright rejected this argument, stating that the defendant's financial argument was one that it "should save for a bankruptcy court." Ultimately, the court granted the plaintiff temporary injunctive relief, requiring the company to continue performance until the issue could be permanently resolved by an arbitrator, as required under the broad arbitration clause in the parties' agreement.

The Bottom Line

As case law continues to evolve, it is possible that Delaware and New York courts may opt to delineate a hierarchically defined set of criteria for efforts clauses. That is not the present reality, however. The moral of today's efforts clause story: Practitioners would be wise to exert some effort drafting guidelines to measure contracted-for efforts clauses. If practitioners opt not to exert that effort, then time spent fighting over efforts terminology is likely time wasted.

Cybersecurity Whistleblowing

Murkier Than You May Think

By Renee Phillips and Shea Leitch

How can your breach turn into a securities law violation? The answer may be, "via whistleblower." More and more, corporate employees are reporting cybersecurity vulnerabilities to the U.S. Securities and Exchange Commission (SEC) after not receiving satisfactory responses from managers about issues they raise. Companies with a strong internal reporting protocol may believe that they need not worry about missing a valid internal report. But organizations should not be so sure. Cyber whistleblowers may present themselves in ways that are virtually unrecognizable from a traditional whistleblower perspective. Recognizing a potential cyber whistleblower may require companies to appreciate nuances previously unanticipated by most internal reporting schemes.

Consider the following scenario: An IT employee approaches his manager. He expresses concern that his co-workers are not following appropriate cybersecurity practices. Specifically, he is aware that employees share passwords for certain systems. The employee knows that his co-workers do this for convenience, but he is concerned that doing so presents a risk to company information. Many managers would not recognize this as a potential whistleblower situation. However, this simple complaint may indeed form the basis for a whistleblower report. If the employee believes that the vulnerability is serious and puts consumer or company information in jeopardy, the employee may take this information to the SEC.

What does the SEC have to do with all this? It's become a very attractive venue for whistleblowers to lodge complaints. The Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Securities Exchange Act to create a bounty program that pays monetary awards to whistleblowers who provide original information about violations of securities law leading to enforcement actions with penalties over $1 million. Whistleblowers who provide qualifying tips receive monetary awards between 10% and 30% of any recoveries, including from related actions.

Securities Law

Cybersecurity weaknesses may form the basis for an alleged securities law violation because securities laws and regulations increasingly require protection of sensitive data. For example, the Gramm-Leach-Bliley Act (GLBA) Safeguards Rule requires companies to protect consumer records through administrative, technical and procedural safeguards. Institutions are required to develop and implement an information security program appropriate for the size, complexity, nature and scope of the financial institution's business. Under this rule, if a company fails to adopt adequate cybersecurity controls or procedures and the failures lead to the exposure of consumer personal information, the company may be found to have violated the Safeguards Rule and, in turn, securities law.

Returning to our example above, the company's failure to maintain an adequate password management protocol could be viewed as a failure to adopt and enforce adequate procedural safeguards under GLBA. In recent years, a robust password management procedure has come to be recognized as a fundamental cyber hygiene practice.

Unlike other types of corporate whistleblowing, cyber whistleblowing may fly under the radar until the whistleblower makes a report to the SEC. The concerns of cyber whistleblowers often arise during the course of normal job duties. Moreover, IT managers may not be aware of the SEC bounty program or that reports need to be elevated. Employees who feel that their valuable advice has not been accepted, and those who feel obligated to come forward out of a sense of civic duty, are increasingly aware of the SEC's prioritization of cybersecurity in its enforcement agenda — and the potential for monetary bounties. And cyber whistleblowers have begun to come forward.

The SEC began signaling its interest in cybersecurity procedures in 2011, when it issued cybersecurity guidance to financial firms. The guidance made clear that the agency considers cybersecurity to be an issue critical to the integrity of financial markets, and advised companies to disclose material cybersecurity risks to shareholders. Since then, the SEC has conducted two examination sweeps aimed at evaluating the cybersecurity posture of financial firms. At that point, the financial industry saw the writing on the wall.

Cybersecurity enforcement actions were an inevitable reality, which came to fruition in September 2015, when the SEC announced the entry of its first consent decree in *In re R.T. Jones Capital Equities Management*. The commission alleged that R.T. Jones, the St. Louis-based investment company, failed to protect its customers' personal information by neglecting to conduct periodic risk assessments, employ a firewall, encrypt personal information and maintain a cybersecurity incident response plan in violation of the GLBA Safeguards Rule. Around the time that the SEC announced the *R.T. Jones* enforcement action and consent decree, senior SEC leaders went to Silicon Valley to let tech leaders know that they were not hidden from the agency's watchful eye. Thus, for both nonfinancial public companies and financial companies, the SEC is determined to take a more

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Cybersecurity

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active regulatory approach, and cybersecurity is high on the enforcement agenda. But companies need not fear cyber whistleblowers. Organizations can implement simple procedures designed to acknowledge employee concerns and encourage them to report internally.

How to Implement Successful Procedures

First, companies must make internal reporting mechanisms available and readily accessible. Employees should be able to report issues, including anonymously, to managers, human resources, compliance, ethics and legal. And they should be able to do so using a telephone, an email hotline or the company's website. Such reporting mechanisms should be made highly visible, and employees should be encouraged to use them when appropriate circumstances arise. Employee handbooks and codes of conduct should explain why it is important to report concerns, and why the company encourages it. Managers should be trained to identify potential whistleblower situations, and to escalate employee concerns in an appropriate way.

Second, companies should safeguard the confidentiality of the whistleblower to the extent possible. Company policies should explain that reports will be treated as confidentially as possible, consistent with the business's need to conduct a proper investigation. For anonymous reports, this means resisting the urge to try to identify the whistleblower. It is very difficult to retaliate against a whistleblower when nobody knows who that individual is. For nonanonymous reports, investigators should nonetheless avoid doing anything to unnecessarily "out" a whistleblower, such as identifying the employee in witness interviews or in document preservation memos. And they should be told not to ask witnesses in an investigation whether they are SEC whistleblowers. The SEC takes the position that employees are not required to inform their employers whether or what they have reported to the SEC.

Third, employee handbooks and codes of conduct should contain anti-retaliation provisions that make clear the organization will not tolerate any adverse action against an individual due to his or her good-faith report of wrongdoing. The policy should direct employees to report any potential retaliation to HR or Legal, and should explain that anyone found to have retaliated against an employee could be subject to discipline up to and including termination. Companies should also appoint an independent representative from Legal or HR to review employment decisions involving a whistleblower, including performance reviews, before they are finalized to ensure that they are not retaliatory and won't expose the company to legal risk.

This is not to say that once someone "blows the whistle," they are immune from employer discipline. But because of the increased risks involved, it is important to have independent review of management decisions involving whistleblowers.

Finally, companies should review their third-party vendor practices (contractors, consultants, auditors, hotline administrators) to ensure that they, too, contain optimal whistleblower procedures. Companies should also ensure that their own policies clearly encourage third-party reports.

Cybersecurity whistleblowing is an emerging area fraught with potential pitfalls. By creating a trusting environment for whistleblowers to report internally, a company can go a long way toward uncovering and remedying violations of law quickly and effectively. And when a company implements procedures designed to adequately address employee concerns and ensure that they feel that their complaints are heard, it may mitigate potential regulatory scrutiny.

Ethics

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Rule 1.8 are unlikely to prove particularly problematic. In such instances, the attorney typically participates in neither the setting nor negotiation of the terms of the plan. On the other hand, if the lawyer does participate in setting any terms or drafting the documentation, it may prove more difficult to establish that the transaction was fair and reasonable to the company. In such instances, the company should, at a minimum, be asked to acknowledge in writing that it consents to the transaction after receiving an opportunity to seek independent counsel, and that it believes the terms of the transaction are fair and reasonable.

Employed Lawyers Coverage

While most everyone is familiar with attorney malpractice claims in the context of a client lawsuit against its outside counsel, legal malpractice actions in the in-house context are not unprecedented. Accordingly, just as attorneys in private practice take pains to ensure that they are insured against such claims, so too must in-house counsel.

As an initial matter, in-house attorneys sometimes assume that they are covered under their organization's directors and officers (D&O) insurance policy. However, the availability and scope of coverage (if any) available to the attorney will depend on nature of the allegations leveled against the attorney. For example, some D&O policies contain exclusions for "professional services" that may bar coverage for legal malpractice claims. Likewise, other D&O policies may exclude "legal advice" from the definition of "wrongful acts" covered under the policy. In some instances, state statues may also offer some protection for in-house counsel. For example in California, employers are generally required to indemnify employees for all losses incurred in direct

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Winning on The Road

A Recent Defense-Side Victory

By Jacob Buchdahl, Arun Subramanian and Mark Hatch-Miller

Many in-house counsel and outside lawyers have experienced something like the following: After navigating your client's defense-side civil case through months or years of contentious discovery, the plaintiff survives summary judgment. Nevertheless, you and your client remain confident that the law and the facts are on your side. There's one big problem, though. Your client faces a jury trial in an unfamiliar jurisdiction, where a jury might be inclined to side with the plaintiff's David over your client's Goliath, and as the old adage goes, "The only certainty with a jury is uncertainty."

Facing the prospect of a trial in a supposedly unfavorable venue, many defendants will agree to settle to avoid an unknown but potentially expensive and reputation-harming verdict. We think there's a better way. We recently tried a defense case in the United States District Court for the Eastern District of Texas and won a conclusive no-liability, zero-damages jury verdict for an out-of-state corporate defendant sued by a local plaintiff. *Flexuspine, Inc. v. Globus Medical*. Here are a few of the strategies we found helpful in that win — many of which we learned from our firm's experience as a plaintiff in the same venue.

1. Stay Cool

Trials are slugfests, and juries and judges know that. But they also expect the lawyers to stay collected and to be respectful to the court, its personnel, the witnesses, and their opponents. Lose sight of that, lose your cool, and you can lose the jury. You want to be the side that the jury is rooting for, even if you are the target of accusations from the other side as a defendant in the case.

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2. Invest in Experienced Local Counsel

A local trial lawyer is the best resource that out-of-town lawyers and out-of-town defendants have for identifying the right jurors for the case. There's no substitute for their inherent understanding of the community's history and relationships that may influence some jurors one way or the other. In addition, some jurisdictions allow much more direct engagement with the jury pool in the jury selection process. The local lawyers we work with are masters of the dying art of *voir dire*, and they can give you tips on how to best relate to the members of the community whose hands your company's fate is in.

3. Bring a Relatable Corporate Representative To Trial

For many defendants — and even some plaintiffs — the first instinct is to bring a high-level executive to represent the company at counsel's table. Often, an employee with a hands-on relationship to the facts of the case may be a better representative for the company. In a patent or products liability case, consider bringing an engineer who worked on the product. Such a representative is the "show, don't tell" version of the typical defense "my client is a good company" line.

4. Choose Your Own Adversary

Successful plaintiffs' lawyers know how to present their clients. In patent cases, for example, plaintiffs are often individual inventors who counsel should portray in the best and most favorable light from the beginning of trial. In these circumstances, a defendant who goes on the attack against the plaintiff — who jurors already see as a victim — will almost always look like a bully. The truth is, however, that those inventors are often not the drivers of the litigation. Behind many of today's patent plaintiffs are litigation funders, hedge funds, trolls, and other companies that have nothing to do with the plaintiff's story of innovation. If you think that direct attacks on the motives and credibility of the plaintiff may backfire, you may be able to find another target, such as a key witness who isn't so sympathetic

5. Embrace Your Client's Identity, Supposed Warts and All

It's never a good idea to run away from who your client is. If your client is a large, out-of-state company, the jury is going to find that out one way or another. Don't be afraid of embracing that identity. In an increasingly "connected" world, appeals to local prejudice are becoming more and more ineffective. Gallup's recent polling on confidence in corporations shows that less than 40% of Americans have "very little" or "no" confidence in big business. Locally biased/anti-big-business jurors in the pool can be easily identified, and usually eliminated, in voir dire.

6. Give Every Lawyer A Speaking Role At Trial

We are firm believers that every lawyer at counsel's table should have a speaking role. Usually, that means taking at least one direct or cross-examination, even for the most junior on the team. This policy is not just good for junior lawyers' career development — it's also good for the client, too. First and foremost, if just one or two lawyers dominate the presentation of the trial, and it turns out the jurors don't like or trust them, your case may be finished. Jurors also appear to pay more attention when there's a mix of voices and personalities throughout trial. Finally, younger jurors may identify more with a young associate on the trial team than a senior partner — hard as that is for senior lawyers to imagine.

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Defense Victory

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7. Be As Succinct As Possible at All Times

We're big believers in a "less is more" approach at trial, starting with the selection of trial witnesses and exhibit lists. Tempting as it may be to throw every helpful document up before the jury during lengthy direct examinations, the reality is that the jury is more likely to be on your side if you focus their attention (and memory) on just a few documents and facts that make the biggest difference. Being succinct (and exceedingly polite) is particularly important during cross-examination. Ten minutes of pointed questioning is usually more effective (and memorable) than hours of in-your-face attacks.

8. Focus on the Facts, and Never Pander to the Jury

Last, but certainly not least, our recent trial experience only increased our faith that jurors pay attention to and care most about the facts. This is particularly true during closing arguments. In our view, jurors don't want to hear rhetoric about who's right and wrong — they want to hear (and see) a summary of what the important documents say and what the witnesses actually said. Jurors also appear to have better recollections of what actually happened during trial than cynical trial lawyers may expect — meaning the worst mistake a lawyer can make is to misstate or distort what the witnesses actually said in any way.

Conclusion

A business that's willing to accept the uncertainty of the jury trial opens the door to the reward of a public exoneration. No settlement can ever bring that "not liable" headline in the legal and industry press—which may well deter others from suing the company in the future. We think following the strategies above may increase the odds of achieving that priceless result.

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Employment Law

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solutions to the healthcare industry, misclassified a class of technical writers as being exempt from overtime wage requirements under the Fair Labor Standards Act (FLSA) and Wisconsin law. There, the plaintiff signed an agreement requiring him to bring wage-and-hour claims "through individual arbitration" and waiving "the right to participate in or receive money or any other relief from any class, collective, or representative proceeding."

The Ninth Circuit's *Morris* case, in turn, arose from allegations that accounting giant Ernst & Young failed to properly classify young accountants under the FLSA and California wage-and-hour law. In that case, the plaintiffs signed an agreement which, by its own terms, was the "sole method for resolving disputes." The agreement further provided that all disputes "pertaining to different Employees will be heard in separate proceedings."

With a 3-2 circuit split on a crucial wage-and-hour question, the Supreme Court is sure to step in.

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Heart of the Battle

Section 7 of the NLRA provides in pertinent part that employees shall have the right to, among other things, engage in "concerted activities for the purpose of collective bargaining or other mutual aid or protection." 29 U.S.C. § 157. Relying on this language, the Pro-Employee Rulings hold that filing collective or class actions is a form of protected "concerted activity."

Conversely, the Federal Arbitration Act (FAA) provides that any contract aiming "to settle by arbitration a controversy thereafter arising out of such contract … shall be valid, irrevocable, and enforceable." 9 U.S.C. § 2. Courts have interpreted the FAA to establish a liberal federal policy that favors arbitration and requires courts to place arbitration agreements on par with other contracts.

Nevertheless, the FAA contains a "saving clause" that allows courts to invalidate arbitration agreements so long as they are deemed invalid on the basis of generally applicable principles of contract law that do not disfavor arbitration. Accordingly, there are two questions that lie at the very heart of this battle: First, do arbitration agreements that provide for compulsory and individual arbitration fall within the purview of the FAA's saving clause? Second, if not, which of the two applicable statutory frameworks should control?

Is the FAA's Saving Clause Applicable?

The Pro-Employer Rulings find that arbitration agreements that contain class or collective waivers do not fall within the ambit of the FAA's saving clause. This is because, on balance, refusing to enforce this kind of agreement discourages the use of arbitration. Relying on the Supreme Court's ruling in *AT&T Mobility v. Concepción*, 131 S. Ct. 1740, (2011) the rulings hold that requiring class arbitration interferes with the fundamental attributes of arbitration. In particular, class or collective proceedings require heightened procedural protections and complex evidentiary considerations that sacrifice arbitration's core principles of efficiency and informality. Accordingly, allowing class arbitration creates a scheme inconsistent with the FAA. Nor is precluding class arbitration a solution because plaintiffs would naturally gravitate toward class litigation. In other words, class or collective mechanisms — whether in court or arbitration — inevitably discourage arbitration. To effectuate the FAA's liberal pro-arbitration policy, then, courts must enforce arbitration agreements that contain class waivers.

The Pro-Employee Rulings reach the exact opposite conclusion based

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consequence of the discharge of their duties unless the employee knew his conduct to be unlawful at the time of his actions.

For in-house counsel looking for additional security, Employed Lawyers Coverage (ELC) may be available and is essentially legal malpractice insurance designed specifically for in-house attorneys. While ELC coverage is not necessary for every in-house attorney, it nonetheless can be a useful extra layer of coverage in a variety of instances; for instance, if there is a possibility that your employer-client might be insolvent (and thus unable to indemnify you) at the time of a malpractice suit.

Conclusion

Far from being a refuge from the Rules of Professional Responsibility, in-house practice is, in fact, an ethics minefield in which practitioners are left attempting to navigate rules often not engineered for their environment. Unfortunately, the focus of the Rules and the attention of most commentators has been fixed on the realm of private practice and the traditional law-firm environment. As a result, in-house lawyers have received little guidance in detecting and handling the particular conflicts issues that arise in their own practice. Nonetheless, care must be taken by in-house practitioners to ensure compliance with these ill-suited rules as the ramifications are just as grave as for their private-practice colleagues.

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on two primary arguments. First, the agreements plainly fall within the scope of the FAA's saving clause because they can be invalidated on the basis of the general principle of illegality because they violate the NLRA. Second, agreements that compel arbitration and forbid class or collective arbitration have the practical effect of prohibiting any form of class or collective proceedings, not just those in arbitration. Therefore, finding those agreements unenforceable does not disfavor arbitration, specifically. Compulsory arbitration remains valid if it permits class arbitration and, conversely, class arbitration waivers remain valid if arbitration is not required.

Which Statutory Framework Controls?

Pro-Employer Rulings conclude there is no evidence that Congress meant the NLRA to override the FAA. First, there is nothing in the text of the NLRA or its legislative history to support such a view. Second, though the FAA was enacted in 1925 and the NLRA in 1935, the FAA was reenacted without substantive change in July 1947. Third, use of class or collective action procedures is not a substantive right. Though the NLRA may be *sui generis*, numerous courts have held that no such substantive right exists in the context of other employment-related statutory frameworks such as the ADEA and the FLSA. Likewise, it is well settled that Federal Rule of Civil Procedure 23, which establishes the class action mechanism, does not create a substantive right.

Even though the Pro-Employee Rulings find there is no need to reconcile or otherwise choose between the NLRA and the FAA, they still address the nature of the right to resolve disputes on a class or collective basis. Unsurprisingly, they conclude the right is substantive. The Pro-Employee Rulings note that every other provision of the NLRA serves to enforce the rights enshrined in Section 7. Thus, if Section 7 does not create a substantive right, the statute's entire structure and policy flounder. Though not expressly stated, the Pro-Employee Rulings intimate this means the FAA cannot trump the NLRA. This conclusion purportedly follows because arbitration cannot abridge or extinguish a substantive right.

What Can Employers Do?

Defendants in the *Morris* and *Lewis* cases have petitioned for writs of certiorari to the U.S. Supreme Court, and briefing is underway. Though the Court is likely to hear one or both cases in the near future, it is nearly impossible to predict how it will rule. The uncertainty is largely the result of the currently vacant seat and the stalled nomination process. With the election now behind us, the coming nomination fights may very well have a significant impact on how this battle is finally resolved.

In the meantime, the circuit-split forces national employers to grapple with inconsistent obligations. Arbitration agreements with class waivers are not likely valid in the following 12 States: Alaska, Arizona, California, Hawaii, Idaho, Illinois, Indiana, Montana, Nevada, Oregon, Washington and Wisconsin. By contrast, the same agreements are likely valid in these 13 States: Arkansas, Connecticut, Iowa, Louisiana, Minnesota, Mississippi, Missouri, Nebraska, New York, North Dakota, Texas, South Dakota, and Vermont. Because the split is geographical, employers should consider transferring lawsuits to more favorable venues whenever possible.

Notably, the Ninth Circuit has held that arbitration agreements with class-waiver provisions are lawful if they allow employees to opt-out of the class-waiver provision. *Mohamed v. Uber Techs., Inc.*, No. 15-16178, 2016 WL 4651409, at *1 (9th Cir. Sept. 7, 2016); *Johnmohammadi v. Bloomingdale's, Inc.*, 755 F.3d 1072 (9th Cir. 2014). Though allowing employees to opt-out undermines the very purpose of such agreements, it ensures the agreements will hold up anywhere within the Ninth Circuit and reduces the number of putative class members. Accordingly, under the current state of the law, employers with significant operations in the Ninth Circuit should give serious consideration to allowing opt-outs.

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Activist Investors

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There is nothing unscrupulous about giving the owners of a company a choice between competing strategies or alternative business plans. Nor is there anything wrong if a majority of shareholders agree with the activist, rather than management. To suggest the contrary is to advocate a corporate system in which management has the final say on all matters, and shareholders have no power to vote managers out of office — a model that might be conventional in Russia, but is antithetical to the very premises of our corporate system.

Myth 5: Shareholders Can Decide That an Activist's Program Has More Merit Than Management's. Put simply, the argument against activist investing boils down to a classic case of blaming the messenger. Activists don't possess some magical power that allows them to bewitch shareholders. Rather, they present a case for their proposed solution to what they perceive as a company's shortcomings. Management has at least an equal ability to present its case. Whether management's case is in defense of a long-held strategy, or a recently created attempt to "be your own activist," the bottom line is that shareholders are the ones who get to decide. If they decide against management, it is hardly the fault of the activist. Viewed rationally, it is the fault of management, either because their program is not as persuasive or because they fail to articulate it successfully.

In the same vein, if shareholders opt for a shorter-term program and reject management's longer-term proposal, the outcome is not wrong just because management disagrees. Even if shareholders are pre-disposed to favor shorter-term programs for extraneous reasons (such as concern for quarterly and annual performance rankings on the part of active money managers), it is not because of something inherently bad about activists. Nor is the solution to penalize activists for their success in harnessing shareholder wishes.

Myth 6: Activist Investors Line Their Pocketbooks at the Expense of Workers, Communities and the Entire American Public. Activist investors cannot prosper unless the other shareholders prosper. To be successful, an activist investor's program must produce sufficient value to increase the price of the company's stock. This is not to say that every activist program will raise the price of the company's stock, but only that to make money, the activist has to be right more often than wrong. As a result, the value created by an activist investor is shared among all shareholders. Indeed, this is the reason why shareholders so often support activist investors' initiatives.

Those other shareholders are, largely, institutional investors who manage a very large part of the combined wealth of the American public. The funds institutional investors manage comprise the largest part of the life savings of our nation held in countless public and private pension funds and innumerable 401K and Roth plans. So activist investors succeed only when institutional investors likewise benefit, thereby increasing the value of the holdings of the various pension plans and individually owned accounts managed by institutional investors.

Myth 7: Company Management and Experts Deserve the Unstinting Support of a Majority of Shareholders. The ultimate myth of the anti-activist mantra is that somehow, for some reason, it shouldn't matter that a majority of shareholders often embrace activist campaigns. The reality is that there is no principled reason to believe that boards, management and their advisers know better and should be freed from the distraction, stress and risk of a debate over their corporate stewardship. The paternalistic and patronizing view that management always knows best is simply an inversion of the reality of shareholders' ownership and rights under our corporate governance system.

Defenders of management against activist investing all too often dismiss the reality that boards and management are accountable to shareholders on at least an annual basis, and that our corporate governance model is based on the fundamental principle that shareholders are the owners of the company with the ultimate right to decide their company's future.

Conclusion

When an activist comes knocking, the company, its managers and its advisers should begin by accepting the reality that the activist always has the ability to appeal to the company's shareholders. Moreover, the evidence is clear that institutional investors who control a majority of almost every public company's stock increasingly favor activist programs over those of management. The reasons for this are many and beyond the scope of this article, but the implications are not.

Managements that reflexively adopt a defensive posture fail to understand that they can only defeat an activist campaign by presenting an alternative that their shareholders will favor. More important, management should understand that discussion with the activist is a far more sensible first step than manning the barricades.

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