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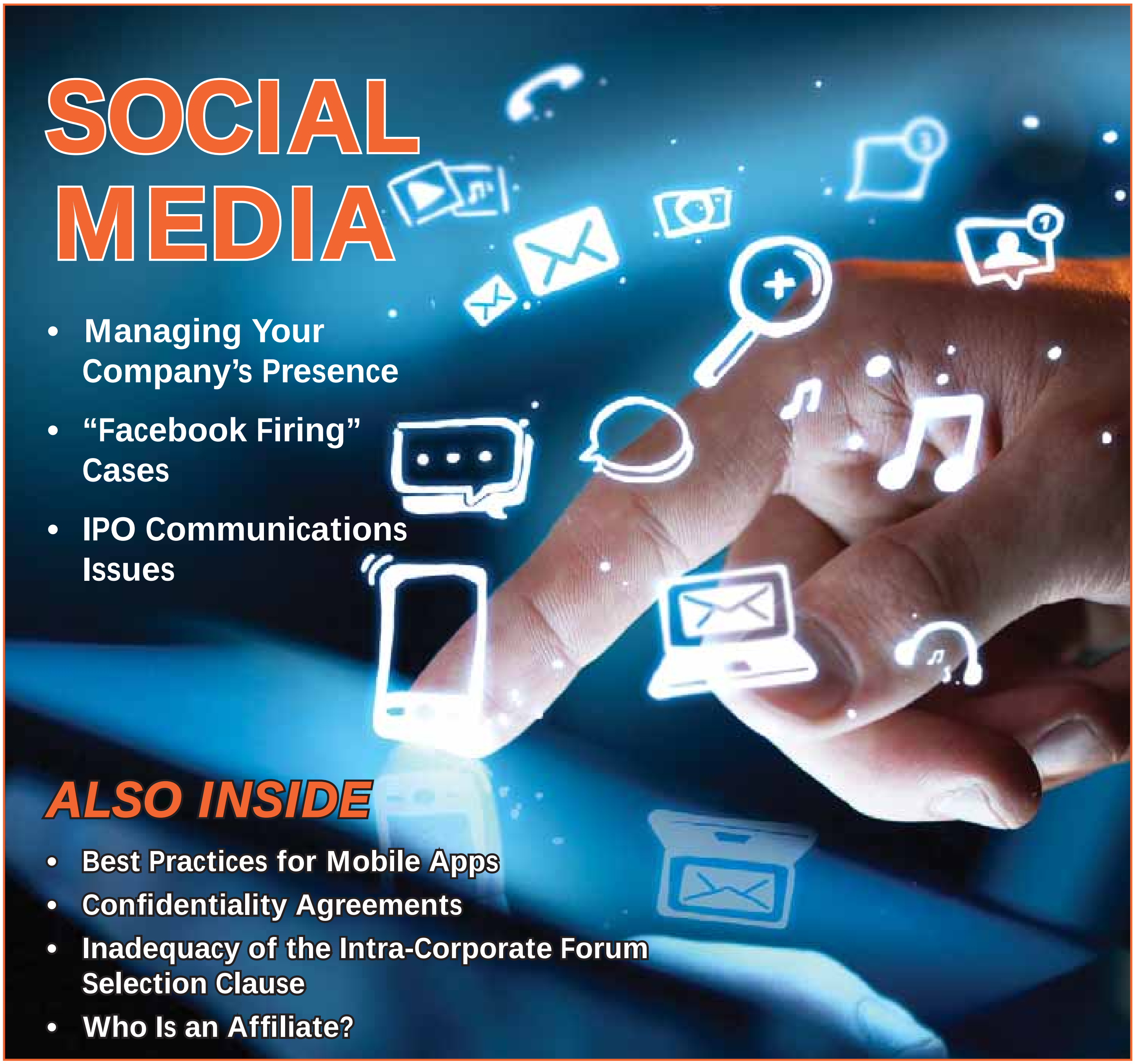

SOCIAL MEDIA

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HeadNotes

Midway through 2013, perhaps the most significant new challenge facing businesses and their attorneys is how to adapt to and manage the use of social media. As the use of social websites such as Facebook, Twitter and LinkedIn continues to expand exponentially, companies are increasingly forced to confront often conflicting dilemmas: on the one hand, how to use these media to compete effectively; on the other, how to maintain control of the use of social media by their employees, whose personal activities online may carry unintended consequences for their employers. In this issue, our contributors explore both of these and other aspects of social media and their implications for businesses and their lawyers.

"As the use of social websites…continues to expand exponentially, companies are increasingly forced to confront often conflicting dilemmas: on the one hand, how to use these media to compete effectively; on the other, how to maintain control of the use of social media by their employees…"

Leading off, attorneys Jeffrey Loop and Alexander Malyshev of Carter Ledyard & Milburn offer both a concise overview of the social media world and a wealth of practical advice for individual companies seeking to effectively manage their online presence. In "How to Manage Your Company's Social Media Presence," they review the explosive growth of the use of such media as Twitter and Facebook by major corporations, and discuss the implications that arise as these media progressively blur the lines between business and personal use. For regulated companies such as financial institutions, the regulatory authorities are in the process of formulating rules and guidelines for this purpose. But even companies that do not operate in a regulated environment face the prospect of greatly expanded litigation and discovery obligations. The authors discuss the regulatory guidance issued to date, and illustrate how this guidance can be a useful basis for companies that are not regulated to adopt and implement best practices for their use of social media as well.

The opposite side of the coin is the pitfalls that lurk in the blurring of the lines between personal and business use of social media by a company's employees—in particular, the clash between the desire of companies to limit and oversee their employees' online activities in order to protect the company's business, and in some cases avoid regulatory violations, and the potential for interfering with employees' right of free association. Under the National Labor Relations Act of 1935, employees have a protected right to join together to better the conditions of their employment. Social media allow employees to communicate across different geographic locations and workshift time differences to an extent never envisioned when the NLRA was passed. At the same time, however, the use of these media raises the potential of a disgruntled employee causing damage to an employer's reputation and business to an extent that bulletin board postings and "water cooler chit chat" could not. In "The Global Water Cooler: 'Facebook Firing' Cases and the Need for a New Standard for Social Media Under the NLRA," John Stapleton begins by reviewing the background of the NLRA and the standards, developed in earlier National Labor Relations Board decisions, by which employees could lose the protection of the NLRA. Mr. Stapleton, a recent graduate of the University of Georgia Law School, then goes on to discuss the Board's review of cases involving employee use of social media. His article offers practical guidance for employers regarding the dangers of overly restrictive policies for social media access, and the circumstances in which it is or is not appropriate to discipline an employee for statements made online.

Yet another of the pitfalls that can befall unwary businesses and their lawyers in the use of social media arises from the securities laws, which generally prohibit communications that improperly stimulate interest in an initial public offering (IPO) of a company's stock—a practice referred to as "gun jumping." In "Jumping the Gun: Social Media and IPO Communications Issues," partner Dwight Yoo and associate Rakhi Patel of Skadden Arps LLP note that while the Securities & Exchange Commission has not yet brought an action based on gun-jumping through the use of social media, a wise issuer is not "jumping the gun" in being aware of the potential for such an action by the SEC. They note that the casual and spontaneous nature of much social media interaction, coupled with the ability for wide and instantaneous dispersion, could readily lead to inadvertent gun-jumping. For example, while a company is not responsible for the online posting of a third party, if it were to republish that posting it could be found in violation. Their article includes a brief primer on gun-jumping rules that provides invaluable guidance for companies contemplating an IPO.

Another area in which the law is developing rapidly in response to the online revolution is in the application of privacy laws to mobile technology. In "California Does It Again!" Recommends Best Practices for the Mobile App Industry," attorney Leonard Ferber discusses how the Golden State has attempted to take the lead in defining best practices for the industry leaders in mobile apps—many, or most, of which are of course based in California. Mr. Ferber, co-head of the Technology practice at Katten Muchin Rosenman LLP, reviews the efforts of the California Attorney General to define best practices for the industry, under the California Online Privacy Protection Act, and similar laws in other states. He outlines the proposed best practices, noting that implementation may be relatively painless for a company that is simply using an online app in furtherance of its core business, but may prove more troublesome for companies seeking to leverage the use of such apps by collecting data.

While issues relating to technology may be grabbing the headlines, the business practitioner should not be neglecting more mundane, but equally consequential, developments. In "Significant Issues Arising Under Confidentiality Agreements (a/k/a Non-Disclosure Agreements)," Melvin Katz and Stuart B. Newman, partners at Salon Marrow Dyckman Newman & Broudy LLP, review two recent cases decided in Delaware Chancery Court that bear upon the interpretation and enforcement of confidentiality agreements, often also referred to as non-disclosure agreements ("NDAs"). Especially, but not exclusively, in the context of prospective merger and acquisition transactions, companies may need to provide otherwise confidential information to each other. The purpose of the NDA is to assure that such private information is not improperly disclosed to third parties. Given their ubiquity, attorneys may tend to rely on a "boilerplate" NDA in these circumstances. But Messrs. Katz and Newman (who is also the founder of and emeritus advisor to the *Journal*) underscore the pitfalls in a "one size fits all" approach. For example, what happens when information is exchanged in contemplation of a friendly transaction that later turns hostile? In these and other circumstances, the authors highlight the importance of drafting the NDA with the same degree of care as the other documents pertaining to the transaction. Their article concisely lays out the holdings of the two cases, and the lessons to be derived from them.

A principal reason businesses and their attorneys turn to the Delaware Chancery courts—indeed, a principal reason that so many businesses are incorporated in Delaware in the first place—is that Delaware has the most highly developed body of corporate law of any state, as well as a court system, the Chancery courts, specifically dedicated to the resolution of corporate law disputes. As a consequence, the interpretation of corporate law, and the outcome of business disputes, are generally more predictable, which in turn enables businesses to plan with greater confidence. But—in a classic illustration of the "law of unintended consequences"—for the same reason, plaintiffs may seek to bring business disputes "anywhere but Chancery," in the hope that the reduced certainty of the result will induce the defendant corporation to settle on terms more favorable to the plaintiff. In "Solving the 'Anywhere But Chancery' Problem: Why the Intra-Corporate Forum Selection Clause is Currently Inadequate," Benjamin Chapple presents a thorough and scholarly elucidation of the "anywhere but Chancery" conundrum; why the intra-corporate forum selection clause in widespread use in business agreements has not been adequate; and the solutions that have been proposed by various commentators, including possible federal intervention into what has historically been a state law preserve. Mr. Chapple is a student at Delaware's Widener University School of Law and Articles Editor of the *Delaware Journal of Corporate Law*.

As in prior issues, the attorneys of Skadden Arps have again contributed their invaluable compendium of securities-related litigation, "Inside the Courts." Among the highlights of this issue's entry are discussions of two Supreme Court cases: *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds* and *Gabelli v. Securities & Exchange Commission*. In the *Amgen* case, the Court resolved a split among the federal circuits, holding 6-3 that a plaintiff does not have to establish that an allegedly fraudulent statement was material in order to obtain class certification. In the *Gabelli* case, the Court unanimously held that the SEC's fraud action against two mutual fund managers was barred by the five-year statute of limitations, since it was filed more than five years after the alleged fraud. When an individual is the victim of a fraud, the statute does not begin to run until the fraud is discovered; but the discovery exception is aimed at protecting individual victims, and thus does not apply to the SEC, said the Court. "Inside the Courts" also reviews significant cases from all of the federal circuits.

American trial lawyers take as a given the need to prepare a witness for testimony before trial. But as our ethics guru, Evan Stewart, recently learned first-hand, what is "Mom, apple pie and the Flag" in the U.S. may not be "Mum, fish and chips, and the Union Jack" across the Pond. In "Mad Dogs and Englishmen," Mr. Stewart compares and contrasts the two judicial systems, with respect to what is and is not allowed with respect to witness preparation. In his usual clear and entertaining style, he lays out a concise summary of the areas in which an American attorney can prepare a witness, without crossing the boundary line into improper territory, while noting that many of these same techniques are not permitted for barristers (or solicitors) in the mother country. His article also discusses another area where the two jurisdictions differ significantly: in the ability of law firms to raise ownership equity from non-lawyers.

Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, every issue of the *Journal* has had at least one article regarding Dodd-Frank and how the regulators are attempting to implement its often vaguely worded provisions through regulations. Our streak remains intact with this issue's "Affiliate, Affiliate, Who Exactly Is an Affiliate?: Ensuring Director Independence for Executive Compensation Committees," by Emily Drazan, a 2013 graduate of Albany Law School. One of the objectives of Dodd-Frank was to rein in excessive executive compensation, and more generally to require the boards of directors of listed companies to act independently in setting executive compensation. To this end, in 2012 the SEC promulgated Rule 10C-1, under which the exchanges must, in their listing standards, require listed companies to consider relevant factors to determine director independence, including, among other factors, whether the director is an "affiliate" of the issuer. In January of this year the SEC approved the new listing standards of the New York Stock Exchange ("NYSE") and the NASDAQ with respect to director independence, which will take effect on July 1, 2013. Ms. Drazan reviews the court cases and SEC no-action letters issued over the eight decades of its existence, in an effort to flesh out the factors that the Commission and the courts have pointed to in determining whether an affiliate relationship exists. Her article provides valuable guidance for business lawyers whose clients are grappling with this issue.

David L. Glass

How to Manage Your Company's Social Media Presence

By Jeffrey Loop and Alexander Malyshev

Background

Having a social media presence has become a necessity of both private and professional life in the 21st century, and managing it effectively is more important than ever. A social media presence can manifest itself in a variety of ways—from commenting fora on websites and live chat systems to more formalized social media platforms such as Twitter, LinkedIn, Facebook and beyond—but in all instances, it projects the company's brand to untold numbers of people.[1] Many of the most popular social media outlets—such as Facebook, which surpassed one billion users in 2012—are blurring the lines between professional and personal social media.[2] As a result, use of social media by companies has exploded, quickly overtaking previous methods of corporate outreach. For example, in 2012 73% of Fortune 500 companies reported using a corporate Twitter account (an 11% increase over the previous year), and 66% had a Facebook page.[3] By comparison, only 28% of these companies had a corporate blog (still, a significant increase over previous years).[4]

As discussed in further detail below, these activities create compliance obligations for regulated entities—such as financial institutions and financial advisors—that are in the process of being addressed and clarified by regulators. But even for non-regulated entities, social media activities can be the focus of potential litigation and discovery obligations. Therefore, in addition to addressing best-practices of social media management (using recent regulator guidance as a reference), this article will briefly discuss a party's obligations once in litigation.

The Importance, and Best Practices, of Social Media Management

As the use of social media by companies has become nearly ubiquitous, companies have begun to grapple with the implications of social media use by both the company and its employees. As summarized below, certain regulated industries are at various stages of implementation of social media policies based on guidance issued by government and industry regulators. Likewise, many professional organizations, such as the American Medical Association, and various legal associations and bar organizations, have issued social media guidance to their members.[5] However, even for companies in unregulated industries, it is important to have a well thought-out, and implemented, social media policy. Certain lessons can be drawn from the guidance issued by the Federal Financial Institutions Examination Council ("FFIEC"), the Securities and Exchange Commission ("SEC"), and the Financial Industry Regulatory Authority ("FINRA") regarding the core principles of such a social media policy. This article will examine the regulatory guidance issued or proposed for financial institutions, with an eye to articulating those lessons for companies in other, unregulated industries.

Social Media Obligations of Regulated Financial Institutions

Recently, the FFIEC—a body that is empowered to "prescribe uniform principles, standards, and report forms for the federal examination of financial institutions" and to "make recommendations to promote uniformity in the supervision" of those financial institutions—promulgated a proposed "Social Media: Consumer Compliance Risk Management Guidance" (the "FFIEC Guidance") to its members.[6] Although the proposed guidance is still in the 60-day comment period as of this writing, it is designed to address "the applicability of federal consumer protection and compliance laws, regulations, and policies to activities conducted via social media by" financial institutions.[7]

These institutions would be expected to "use the guidance in their efforts to ensure that their risk management practices adequately address the consumer compliance and legal risks, as well as related risks, such as reputation and operational risks, raised by activities conducted via social media." The FFIEC recognizes that this form of customer interaction "tends to be informal and occurs in a less secure environment" and therefore presents "unique challenges" to these institutions. According to the FFIEC, one of the principal ways risk can increase is from "poor due diligence, oversight, or control" of the social media activities by the financial institution.[8] Therefore, the guidance is designed to "ensure institutions are aware of their responsibilities to oversee and control these risks within their overall risk management program." Specifically, the guidance provides that:

- A financial institution should have "a risk management program that allows it to identify, measure, monitor, and control the risks related to social media," and the "size and complexity" of the program should be "commensurate with the breadth" of its social media activities.
- The risk management program should be "designed with participation from specialists in compliance, technology, information security, legal, human resources, and marketing." As part of that process, it should have an "[a]udit and compliance functions to ensure ongoing compliance with internal policies and all applicable laws, regulations, and guidance."

- This program should include a "governance structure with clear roles and responsibilities whereby the board of directors or senior management direct how using social media contributes to the strategic goals of the institution" and "establishes controls and ongoing assessment of risks in social media activities." This would include parameters "for providing appropriate reporting to the financial institution's board of directors or senior management."
- The institution should have policies and procedures "regarding the use and monitoring of social media and compliance with all applicable consumer protection laws, regulations, and guidance." These policies and procedures "should incorporate methodologies to address risks from online postings, edits, replies, and retention."
- The institution should have "[a]n employee training program that incorporates the institution's policies and procedures for official, work-related use of social media, and potentially for other uses of social media, including defining impermissible activities."
- The institutions should have a "due diligence process for selecting and managing third-party service provider relationships in connection with social media" and an "oversight process for monitoring information posted to proprietary social media sites administered by the financial institution or a contracted third party."

The Proposed Guidance further provides that even if a financial institution "has chosen not to use social media," it "should still be prepared to address the potential for negative comments or complaints that may arise within the many social media platforms described above and provide guidance for employee use of social media[]" that is not run or managed by the company.[9] Substantively, the Proposed Guidance identifies several laws that apply to various financial institutions. Although the laws addressed are beyond the scope of this article,[10] generally they deal with the financial institutions' disclosure obligations, and the FFIEC explicitly warns that the "laws discussed in this guidance *do not contain exceptions regarding the use of social media.*"[11] In other words, although the communications are "less formal," laws that "can expose an institution to enforcement actions and/or civil lawsuits" must be observed even in that context.[12]

Social Media Obligations of Individuals and Entities Regulated by the SEC and FINRA

Other professionals in regulated industries also face compliance requirements with regard to their use of social media. For instance, a little over a year ago, the SEC Office of Compliance Inspections and Examinations, in consultation with the staff of FINRA, issued a "National Examination Risk Alert," entitled "Investment Adviser Use of Social Media" (the "Alert").[13] Broadly, the Alert is aimed at helping registered investment advisers ("RIA's") in "designing reasonable procedures designed to prevent violations of the Advisers Act and other federal securities laws" (such as the antifraud, compliance and recordkeeping provisions of the Exchange Act) by, *inter alia,* issuing usage guidelines and content standards, providing sufficient monitoring, approving content, and providing training.[14] The Alert contains recommendations from the staff about areas to consider with regard to these issues.

The Alert further stresses that special obligations arise with respect to third-party content and recordkeeping responsibilities. For instance, RIA's must consider whether statements made by third parties on a social media website constitute "testimonials," the publication of which would constitute a "fraudulent, deceptive, or manipulative act" of the RIA prohibited by the Advisers Act.[15] The SEC Staff has determined that "depending on the facts or circumstances," the use of "social plug-ins," such as the "like" button on Facebook, could be a testimonial under the Advisers Act. An example of prohibited conduct could include an invitation to the public to "like" an investment advisory representative's biography posted on a social media site, since that election could be viewed as a type of testimonial prohibited by Rule 206(4)-1(a)(1) of the Advisers Act. With respect to recordkeeping obligations under Rule 204-2,[16] the SEC Staff warns that the recordkeeping obligations do not "differentiate between various media," be they paper or electronic communications (including social media posts) that relate to the advisers' recommendations or advice. Because these are third-party sites, firms are encouraged to "determine that [they] can retain all required records related to social media communications and make them available for inspection."[17]

Similarly, FINRA issued at least two Regulatory Notices ("RN") that relate to the use of social media by its members (RN 10-06, issued January 2010, and 11-39, issued August 2011). These RNs are covered in greater detail in a previous article by Ethan L. Silver and Faith Colish, entitled "FINRA Guidance on Social Media Used for Business Purposes."[18] RN 10-06 made clear that firms had an obligation to have written policies and procedures to supervise employees' participation in social media, and one best practice alternative would be to "consider prohibiting all interactive electronic communications that recommend a specific investment product and any link to such a recommendation unless a registered principal has previously approved the content."[19] In a precursor to the SEC's "testimonial" admonition, RN 10-06 warned that a FINRA member could become responsible for a third-party's post on a social network if "the firm or its personnel explicitly or implicitly" endorse or approve the post.[20] RN 11-39 went into greater detail with respect to a FINRA member's recordkeeping obligations under the Securities Exchange Act of 1934 and the NASD Rules.[21] RN 11-39 also elaborated on interaction with third persons (and an associated person's obligations in interacting with these actors), and again stressed that firms must (i) adopt appropriate training and education concerning its social media policies, and (ii) keep a close eye on compliance with those policies.[22]

Lessons for Companies and Professionals in Unregulated Industries

Even companies and professionals in unregulated industries are wise to develop a social media policy to avoid reputational risk, with an eye to potential litigation down the road. The FFIEC guidance with respect to reputational risk is particularly instructive in thinking about these dangers. As outlined in the guidance, activities "that result in dissatisfied customers and / or negative publicity could harm the reputation and standing" of the company even if it has violated no law.[23] The reputational risks include: fraud and brand identity (which includes "spoofs" of institution communication and fraudsters masquerading as the institution), the activities of third parties contracted to manage the online identity of the company, privacy concerns arising from users posting sensitive information on the company's page, and consumer complaints made directly on the social media website and how the company responds to such complaints.[24] As mentioned above, a common thread emerges in the guidance issued by the FFIEC, the SEC and FINRA regarding effective management. Although not nearly as detailed as the FFIEC proposals, both FINRA and the SEC-issued guidance track the core principles of an effective management of social media policy: (1) well thought-out, and detailed, written policies regarding use of social media by employees, (2) training of personnel regarding applicable laws and rules, and (3) effective supervision by management. These policies need to be developed, and implemented, in consultation with knowledgeable professionals familiar with your business and industry.

At the outset, the breadth and scope of the social media policy needs to be carefully thought out. For instance, even companies in unregulated industries may be parties to collective bargaining agreements and as a result must consider how to tailor their policies narrowly enough so as not to infringe on the protected rights of employees. In a paper published by the U.S. Chamber of Commerce in August of 2011, entitled "A Survey of Social Media Issues Before the NLRB," the chamber observed that of the over 100 charges related to social media activities before the NLRB between 2009 and May of 2011, the "vast majority" fell "into two general categories: employer policies restricting employee use of social media that are alleged to be overbroad and employer discharge or discipline based on an employee's comments posted through social media channels."[25] Therefore, a careful balance must be struck between the employee's freedom of expression and expectations of privacy and the company's reputational risk.[26]

Needless to say, a policy is only as effective as its implementation and supervision. As the FFIEC guidance states, and FINRA and SEC rules relating to supervision reinforce, ultimate responsibility for this implementation and supervision rests with the company's upper management. In many ways, the social media presence is becoming the new "face" of the company in the same way that more traditional public relations releases used to be. Therefore, the company as a whole can be harmed by the employees' actions and it is important for higher management to be involved in the formulation and delegation of supervisory authority for the social media training programs.

A Company's Obligations Regarding Social Media Once Litigation Is Threatened or Commenced

As outlined above, regulated industries have numerous laws and rules governing the preservation of information which can serve as an independent basis for liability should the company be the subject of a lawsuit or enforcement action. But even companies not subject to heightened retention policies should critically examine their policies regarding social media information in anticipation of litigation.

Generally, once litigation has commenced, the scope of what information an opposing party may seek is very broad. For instance, the New York Civil Practice Law and Rules ("CPLR") provide that "[t]here shall be full disclosure of all matter material and necessary in the prosecution or defense of an action…by [a] party.…"[27] This discovery is not limited to "evidence" that could be used at trial, but to any information "reasonably calculated to lead to the discovery of information bearing on the claims."[28] Thus, once in litigation, an adversary may request and access any information that is "relevant" or "likely to lead to the discovery of relevant" evidence, and New York courts will routinely grapple with the balance between an adversary's legitimate requests for "relevant" information and "fishing expeditions" (designed in some cases to harass or embarrass an opponent and to make litigation more burdensome). These are the same considerations that underpin the federal rules.[29]

Company Facebook pages, as well as other forms of social media interaction, are inherently "public," and therefore the company would be hard pressed to argue that it has any expectation of privacy, or any other basis, for withholding social media information.[30] Once the minimal burden of relevancy is established, postings are "not shielded from discovery merely because plaintiff used the service's privacy settings to restrict access just as relevant matter from a personal diary is discoverable."[31] Such postings may even go as far as destroying the attorney-client privilege should litigation be commenced.[32]

Finally, it is crucial to note that an attorney cannot advise a client (and a party should not on its own undertake) to clean up or remove damaging postings from social media pages in connection with an ongoing litigation. An attorney in Virginia and his client were sanctioned $542,000 and $180,000, respectively, for engaging in such a Facebook "clean up."[33]

Conclusion

In conclusion, companies must develop, implement, and monitor an effective social media strategy from the very top. As social media presence becomes more and more ubiquitous, this task becomes more and more critical.

Endnotes

1. A comprehensive definition of "social media" is nearly impossible, but the Federal Financial Institutions Examination Council's working definition is helpful. It defines social media activities broadly, including "micro-blogging sites (e.g., Facebook, Google Plus, MySpace, and Twitter); forums, blogs, customer review web sites and bulletin boards (e.g., Yelp); photo and video sites (e.g., Flickr and YouTube); sites that enable professional networking (e.g., LinkedIn); virtual worlds (e.g., Second Life); and social games (e.g., FarmVille and CityVille)." The central criterion is that the "communication tends to be more interactive."
2. Examples of this blurring include Facebook's move into the job search sector and the company's new "Facebook Graph Search," and its "Pages," which are a company's website on the Facebook platform that allows constant, two-way interaction with other Facebook users. Likewise, LinkedIn has introduced company pages (which allow varied degrees of interaction with users). Other examples include Twitter, which allows organizations to have official, or "verified," handles, and Google, which is attempting to make web searching "social" by allowing individual users to endorse, or "+1," search results.
3. *See* Barnes, Lescault & Andonian, *Social Media Surge by the 2012 Fortune 500: Increase Use of Blogs, Facebook, Twitter and More*, Charlton College of Business and Marketing Research, University of Massachusetts Dartmouth, http://www.umassd.edu/cmr/socialmedia/2012fortune500/ (last visited Apr. 24, 2013).
4. *Id.*
5. *See New AMA Policy Helps Guide Physicians' Use of Social Media*, Am. Med. Ass'n (Nov. 8, 2010), http://www.ama-assn.org/ama/pub/news/news/social-media-policy.page; *Social Media Resources for Bar Associations*, Am. Bar Ass'n Div. for Bar Servs., http://www.americanbar.org/groups/bar_services/resources/socialmedia.html (last visited Apr. 21, 2013); *Social Media and the Courts Resource Guide*, Nat'l Ctr. for State Courts, http://www.ncsc.org/Topics/Media/Social-Media-and-the-Courts/Resource-Guide.aspx (last visited Apr. 21, 2013); *Social Media Guide for Lawyers v. 2.0*, Meritas (2012), *available at* http://docs.meritas.org/Resources/SMGuide.pdf.
6. *See Social Media: Consumer Compliance Risk Management Guidance*, Fed. Fin. Insts. Examination Council, FFIEC Docket No. FFIEC-2013-001 (Jan. 17, 2013), *available at* http://www.ffiec.gov/press/Doc/FFIEC%20social%20media%20guidelines%20FR%20Notice.pdf. The FFIEC Council is composed of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, as well as the State Liaison Committee ("SLC"), which includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. *See* Fed. Fin. Insts. Examination Council http://www.ffiec.gov/ (last modified Feb. 22, 2013). The request for comments is available at FFIEC Guidance.
7. FFIEC Guidance, *supra* note 6, at 4. They include banks, savings associations, and credit unions, as well as by nonbank entities supervised by the Consumer Financial Protection Bureau, and those entities that are supervised by the SLC members.
8. *Id.* at 4–6.
9. FFIEC Guidance, *supra* note 6, at 9–11.
10. For instance, according to the proposed guidance, social media communications can trigger, among other things, obligations under (i) the Truth in Savings Act, (ii) the Equal Credit Opportunity Act, (iii) the Fair Housing Act, (iv) the Truth in Lending Act, (v) the Real Estate Settlement Procedures Act, (vi) the Fair Debt Collection Practices Act, (vii) unfair and deceptive practices under the Federal Trade Commission Act and Dodd-Frank, as well as various other Regulations. *See generally* FFIEC, *supra* note 6, at § IV ("Risk Areas").
11. *See* FFIEC Guidance, *supra* note 6, at 12.
12. *Id.* For instance, the FFIEC Guidance suggests that depository institutions subject to the Community Reinvestment Act should "ensure their policies and procedures" addressing public comments maintained in their public file also "include appropriate monitoring of social media sites run by or on behalf of the institution." *Id.* at 23.
13. *See* Office of Compliance Inspections and Examinations, *National Examination Risk Alert*, Vol. 2, Issue 1, Jan. 4, 2012, *available at* http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf.
14. *See id.*at 1, 2 n.4.
15. *See id.* at 6 n.15; 17 C.F.R. § 275.206(4)-1(a)(1) (2013).
16. National Examination Risk Alert, *supra* note 13, at 6; 17 C.F.R. § 275.204-2 (2013).
17. *See* National Examination Risk Alert, *supra* note 13, at 6.
18. Ethan L. Silver & Faith Colish, *FINRA Guidance on Social Media Used for Business Purposes*, Carter Ledyard & Milburn LLP (Sept. 22, 2011), http://www.clm.com/publication.cfm?ID=345&Att=119; FINRA Regulatory Notice 10-06, *Social Media Websites, Guidance on Blogs and Social Networking Web Sites* (Jan. 2010), http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120779.pdf; FINRA Regulatory Notice 11-39, *Social Media Websites and the Use of Personal Devices for Business Communications, Guidance on Social Networking Websites and Business Communications* (Aug. 2011), http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf.

   Last June FINRA also issued RN 12-29, which advises members of the SEC's approval of FINRA's proposed rule change to adopt NASD Rules 2210 and 2211, together with NASD Interpretive materials, as FINRA Rules 2201 and 2212–2216 (collectively the Communication Rules). These Communication Rules became effective February 4, 2013, and in relevant part address the requirement, and exceptions to the requirement, of principal pre-approval of "Retail Communications," defined to include "any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period." Although FINRA-regulated entities should become familiar with these Communication Rules, they are beyond the scope of this article. *See* FINRA Regulatory Notice 12-29, *Communications with the Public, SEC Approves New Rules Governing Communications With the Public* (Jun. 2012), http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p127014.pdf.

19. *See* FINRA Regulatory Notice 10-06, *supra* note 18, at 4. Among other things, RN 10-06 made clear that (1) communications with customers through social media were subject to the retention requirements of the Exchange Act and the NASD Rules, (2) investment recommendations made through such social media could trigger the suitability requirements under NASD Rule 2310, and (3) participation in Blogs, Facebook, Twitter and LinkedIn (as well as other social media) had to be supervised, and could constitute advertisement under NASD Rule 2210 if the communications were "static." *See id.* at 3–5.

20. *See id.* at 7–8.

21. *See* FINRA Regulatory Notice 11-39, *supra* note 18, at 2–3.

22. *See id.* at 2, 6. RN 11-39 also introduced a "knowledge" requirement to links to third-party websites, whereby a statement may be deemed "adopted" by virtue of knowledge of its falsity (even if the firm has not otherwise "adopted" or become "entangled" with the content of the website). *See id.* at 6.

23. *See* FFIEC Guidance, *supra* note 6, at 26–27.

24. *Id.* at 26–30.

25. *See* Michael J. Eastman, *A Survey of Social Media Issues Before the NLRB*, U.S. Chamber of Commerce, at 4. http://www.uschamber.com/sites/default/files/reports/NLRB%20Social%20Media%20Survey.pdf (the survey was based on a FOIA request response by the NLRB, which included 117 charges, 7 complaints, and 5 settlement agreements, relating to social media activities, between 2009 and May of 2011). *See* FFIEC Guidance, *supra* note 6, at 2. In addition to the general categories outlined above, additional issues concerned "whether the employer bargained with a union over a social media policy and union communications during an organizing campaign." *Id.* at 4. The survey included "Examples of Issues Raised in Charges," at Section VI, and "Examples of Employer Policies Alleged to be Overbroad," at Section VII.

26. *See* FFIEC Guidance, *supra* note 6, at 29 (as the FFIEC Guidance stresses, employee activities, even though their personal social media accounts, "may be viewed by the public as reflecting the financial institution's official policies" or otherwise reflect poorly on the institution).

27. *See* N.Y. C.P.L.R. 3101(a)(1) (McKinney 2013); Fed. R. Civ. P. 26(b)(1) ("Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense [and f]or good cause, the court may order discovery of any matter relevant to the subject matter involved in the action.").

28. Crazytown Furniture, Inc. v. Brooklyn Union Gas Co., 541 N.Y.S.2d 30, 32 (App. Div. 2d Dep't 1989). See Fed. R. Civ. P. 26(b)(1), explaining that the FRCP make this explicit by stating that the information sought "need not be admissible" if the discovery "appears reasonably calculated to lead to the discovery of admissible evidence."

29. *See* Collens v. City of New York, 222 F.R.D. 249, 253 (S.D.N.Y. 2004) ("While Rule 26(b)(1) still provides for broad discovery, courts should not grant discovery requests based on pure speculation that amount to nothing more than a 'fishing expedition' into actions or past wrongdoing not related to the alleged claims or defenses.").

30. *See, e.g.*, United States v. Meregildo, 883 F. Supp. 2d 523 (S.D.N.Y. 2012) ("Whether the Fourth Amendment precludes the Government from viewing a Facebook user's profile absent a showing of probable cause depends, *inter alia*, on the user's privacy settings."); Romano v. Steelcase, Inc., 907 N.Y.S.2d 650 (Sup. Ct. Suffolk County 2010) ("As neither Facebook nor MySpace guarantees complete privacy, Plaintiff has no legitimate reasonable expectation of privacy.… Thus, when Plaintiff created her Facebook and MySpace accounts, she consented to the fact that her personal information would be shared with others, notwithstanding her privacy settings. Indeed, that is the very nature and purpose of these social networking sites else they would cease to exist. Since Plaintiff knew that her information may become publicly available, she cannot now claim that she had a reasonable expectation of privacy."). *Id.* at 656.

31. Patterson v. Turner Constr. Co., 931 N.Y.S.2d 311, 312 (App. Div. 1st Dep't 2011) (internal citations omitted).

32. *See* Lenz v. Universal Music Corp., No. 5:07-CV-03783, 2010 WL 4789099, at *1 (N.D. Cal. Nov. 17, 2010) (describing a client who waived the privilege by discussing attorney's motivation to represent her *pro bono*, her decision to abandon certain claims, and factual allegations of the case on social media).

33. *See* Lester v. Allied Concrete Co., No. CL08-150, 2011 WL 8956003 (Va. Cir. Ct. Sept. 1, 2011); Lester v. Allied Concrete Co., No. CL08-150, 2011 WL 9688369 (Va. Cir. Ct. Oct. 21, 2011).

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The Global Water Cooler: "Facebook Firing" Cases and the Need for a New Standard for Social Media Under the NLRA

By Jack Stapleton

Introduction

"It's the same as talking at the water cooler," said Lafe Solomon, Acting General Counsel of the National Labor Relations Board.[1] Shortly after, the Board issued its first complaint involving employees' use of social networking sites such as Twitter and Facebook, drawing national attention ever since.[2]

In hindsight, it was only a matter of time before the National Labor Relations Board ("NLRB" or "the Board") inserted itself into the intersection of social media and employment relations.[3] Since 1935, Congress has protected the rights of employees to join together to better the conditions of their employment.[4] Historically, workplace communication consisted of posted bulletins, printed flyers, or word of mouth.[5] However, as people increasingly assimilate social media into their daily means of communication, the NLRB must attempt to reconcile seventy-five-year-old labor laws with the technological realities of modern-day virtual communication.[6]

As a prominent author put it, just a few years ago "Facebook didn't exist; Twitter was a sound; the [c]loud was in the sky; 4G was a parking place; LinkedIn was a prison; applications were what you sent to college; and Skype for most people was [a] typo…."[7] When Facebook was launched in 2004 across American college campuses, 757 million people throughout the world were using the Internet.[8] As of September 2011, Facebook had over 800 million active users, which means the social media giant now has a greater reach than the Internet did seven years ago.[9] Facebook is currently the second most visited Internet site in the world behind Google, and Twitter ranks in the top 10.[10] Just a year ago, Twitter reported 65 million "Tweets" per day.[11] In August 2011, the site boasted over 200 million Tweets per day.[12] Indeed, it is becoming clear that social media is no longer a fad, but rather embedded in the way people communicate.

Social media's flexibility, informality, and capability to reach an enormous audience[13] provide a new means for coworkers to discuss the workplace—regardless of the obstacles presented by differently timed shifts, physically separated workplaces, and the operational demands of work.[14] Through a Tweet or a Facebook post, an employee can spread information quickly, efficiently, and inexpensively to coworkers or the general public[15] without ever leaving his / her couch. This poses a great threat to employers, as it increases the chances for damaging defamation and disparagement of company products.[16] As people continue to integrate social media into their daily means of communication, they may feel more comfortable exposing their personal feelings about their employer—especially if the employer has taken advantage of the site's privacy settings.[17] Although social media sites allow users to restrict access to their posts through privacy settings, they cannot prevent someone with access to that information from sharing it.[18] Furthermore, many individuals connect with others whom they know little or nothing about, leading to an unknown network of people with the ability to view one's unedited thoughts.[19]

The increasing use of social media to vent job-related complaints might lead one to conclude—as the Acting General Counsel for the NLRB did[20]—that a Facebook post is no different from an informal conversation at the water cooler, even if the conversation is much louder and more permanent.[21] Alternatively, one can conclude that "yesterday's water cooler talk is not the same as broadcasting disparaging comments on Facebook that could reach millions of people."[22] Because of the changing environment of employee communication, most people agree that "law[s] based on outdated assumptions…may need some tweaking."[23]

I. Background

The National Labor Relations Board is an independent federal agency that Congress created in 1935 to administer the National Labor Relations Act ("NLRA"), which is the basic law governing labor relations between employers and employees.[24] Under section 7 of the NLRA, employees are guaranteed the right "to engage in other concerted activities for the purpose of…mutual aid or protection…."[25] Although the NLRA primarily addresses union-related activities, section 7 protects employees' rights to discuss wages and working conditions—regardless of whether a worker is a union member.[26]

A. Concerted Activity Under the NLRA

There is nothing in the legislative history of section 7 that specifically indicates what Congress intended to be the scope of the term "concerted activities."[27] Courts and the Board have consistently protected concerted activity by both groups and individual actors.[28] The NLRB has provided an evolving interpretation of "concertedness" over time,[29] in an attempt to clarify the "precise manner" in which individual action "must be linked to the actions of fellow employees" in order to satisfy the statutory requirement of concerted activity.[30]

In 1975, in *Alleluia Cushion Co.*, the NLRB adopted a broad "constructive concert" theory for when an employee acting alone satisfies the concerted requirement of section 7.[31] Under this theory, when an individual employee's action involves a matter of "mutual concern" or potential benefit to other employees, consent is implied thereto and the activity is deemed concerted.[32] No circuit court ever approved the *Alleluia Cushion* doctrine; in fact, two courts expressly rejected it.[33] The Ninth Circuit described the implied concerted action theory as an "unwarranted expansion of the definition of concerted action unsupported by statutory basis."[34]

Alleluia Cushion was eventually overturned by the Board in *Meyers* in favor of the traditional test for concerted activity.[35] Under the *Meyers* line of cases, the Board emphasized an "objective" standard that requires an individual employee's activity to be "engaged in with or on the authority of other employees, and not solely by and on behalf of the employee himself."[36] This standard for concerted activity includes circumstances where an individual "seek[s] to initiate or to induce or to prepare for group action" or where the activity has "some relation to group action in the interest of the employees."[37] In support, the Board noted "the Supreme Court has repeatedly recognized…that it is protection for *joint* employee action that lies at the heart of the Act."[38]

Although *Meyers* continues to be the main test for concertedness,[39] several Board decisions have expanded the analysis.[40] For example, the Board also protects individual activities that are the "logical outgrowth of concerns expressed by a group of employees."[41] However, the Board has long held that "activity which consists of mere talk must…be talk looking toward group action" to be protected.[42] As such, individual, isolated "gripes" do not generally constitute concerted activity.[43]

B. Losing the Act's Protection

It is well established that concerted activity is protected where it pertains to wages, benefits, or other terms and conditions of employment.[44] Activity that is unlawful, violent, or in breach of contract does not constitute protected concerted activity under the NLRA.[45] Further, employees may lose protection under the NLRA pursuant to the *Atlantic Steel* or *Jefferson Standard* doctrines.[46] *Atlantic Steel* is generally applied to an employee who has made public outbursts against a supervisor, while *Jefferson Standard* is typically applied where an employee has made disparaging comments about an employer or its product in the context of appeals to third parties.[47]

In *Atlantic Steel Co.*, the Board recognized that even an employee who is engaged in protected concerted activity may lose the protection of the Act through "opprobrious conduct."[48] This determination is based on a balancing of several factors: (1) the place of the discussion; (2) the subject matter of the discussion; (3) the nature of the employee's outburst; and (4) whether the outburst was, in any way, provoked by an employer's unfair labor practice.[49]

In *Jefferson Standard*, the Supreme Court explained that an employee's protected concerted activity may lose the Act's protection if it constitutes "insubordination, disobedience, or disloyalty."[50] The Court found protecting such conduct would not further "the Act's declared purpose of promoting industrial peace and stability."[51] Following *Jefferson Standard*, the Board developed its own two-part test for when an employee's communication to a third party is deemed protected under section 7: (1) the communication must be related to an ongoing labor dispute, and (2) it must not be so "disloyal, reckless or maliciously untrue as to lose the Act's protection."[52]

C. Unfair Labor Practices

Section 8(a)(1) provides that "it shall be an unfair labor practice for an employer to interfere with, restrain, or coerce employees in the exercise" of their section 7 rights.[53] Thus, an employer's discharge or discipline of an employee for conduct considered to be protected concerted activity is an unfair labor practice and violates section 8.[54]

An employer can also be found in violation of section 8(a)(1) through the maintenance of a work rule that would "reasonably tend to chill employees in the exercise of their section 7 rights."[55] The Board uses a two-step inquiry to determine if a work rule would have such an effect.[56] First, a rule is unlawful if it *explicitly* restricts activities protected by section 7.[57] For the second step, the Board has held:

> If the rule does not explicitly restrict activity protected by Section 7, the violation is dependent upon a showing of one of the following: (1) employees would reasonably construe the language to prohibit Section 7 activity; (2) the rule was promulgated in response to union activity; or (3) the rule has been applied to restrict the exercise of Section 7 rights.[58]

In *Lutheran Heritage*, the Board emphasized that this inquiry must begin with a "reasonable reading" of the rule, cautioning against "reading particular phrases in isolation."[59] However, where a policy can reasonably be read to have a chilling effect, the Board may find mere maintenance of the policy to be an unfair labor practice, even absent enforcement.[60]

D. Social Media and the NLRB

The intersection of traditional labor law and social media has presented many new issues for the NLRB, employers, and employees.[61] A survey conducted by the United States Chamber of Commerce revealed that by August 2011, the NLRB had reviewed more than 129 cases involving social media.[62] The vast majority of the NLRB's social media cases have fallen into two general categories: (1) overbroad employer policies restricting employee use of social media and (2) employer discipline based on the contents of an employee's Facebook or Twitter post.[63] Although there is significant precedent regarding non-disparagement and employee loyalty in other contexts, application of the precedent to social media is a major developing issue.[64]

In August 2011 the NLRB Office of the General Counsel released a report summarizing its position on this new area of the law.[65] The report, which describes the outcome of investigations into fourteen cases, is one of the first detailed explanations about how existing laws are applied to social media in the workplace[66] and has received significant media attention.[67] The new scrutiny has alarmed many businesses,[68] and publicity surrounding the NLRB's recent focus on social media has resulted in further confusion because many private sector employers are not familiar with the NLRA and have never had any direct dealings with the agency.[69] Although the report provides helpful guidance for employers on the NLRB's current position, the actual legal limits on an employer's ability to regulate social media usage have yet to be fully addressed by the NLRB or by the federal appellate courts that review its decisions.[70]

E. Sample of Social Media Cases

1. American Medical Response of Connecticut

In October 2010 the NLRB made national headlines[71] when it issued an unfair labor practice complaint against American Medical Response of Connecticut ("AMR").[72] This marked the first time the NLRB took a position in a case involving a firing related to social media.[73] After a dispute with her supervisor, an AMR employee posted disparaging remarks about the supervisor on Facebook—referring to him as a "scumbag," a "dick," and a "section 17" (i.e., the company's code for a psychiatric patient)[74]—which drew supportive responses from her coworkers.[75] The employee was subsequently terminated for violating a company policy that prohibited employees from making disparaging comments when discussing the company or its supervisors on the Internet.[76]

The NLRB concluded that the employee engaged in protected concerted activity "by discussing supervisory actions with coworkers in her Facebook post."[77] It then concluded the employee did not lose the Act's protection because the *Atlantic Steel* balancing test favored a finding that the conduct was protected.[78] In its inquiry, "the NLRB downplayed the nature of the outburst"[79]—deeming it "name-calling"—because (1) it "was not accompanied by verbal or physical threats" and (2) the Board has found more egregious name-calling protected in the past.[80] The General Counsel then concluded the language of the social media policy violated section 8(a)(1) because it was overbroad and would prohibit an employee from engaging in protected activity.[81]

In February 2011 the NLRB released a press report announcing a settlement with AMR, stating that the employer "agreed to revise its overly-broad rules" and that it "would not discipline or discharge employees for engaging in such discussions."[82] Although it was the first case to analyze the legality of employer social media policies in the context of disparaging remarks on a social media site,[83] the settlement left the legal line between Facebook griping and concerted activity uncertain.[84]

2. Hispanics United of Buffalo, Inc.

In September 2011, the NLRB attracted further media attention when a NLRB administrative law judge ("ALJ") issued the first ruling on a Facebook firing case, holding that Hispanics United of Buffalo ("HUB")—a nonprofit services provider—unlawfully discharged five workers after they posted comments on Facebook related to their work environment.[85] The conflict began when an employee, prior to a scheduled meeting with management about working conditions, posted a message on her Facebook page asking her coworkers how they felt about an employee's allegations that they did not do enough to help HUB's clients.[86] The employee's post drew responses from other employees who defended their job performance, citing workload and staffing issues.[87] Some posts contained more offensive language, sarcastically characterizing the company's clients as lazy and unappreciative.[88] Upon learning of the posts, HUB fired the five employees who participated, claiming that their profane comments constituted harassment of the employee mentioned in the original post.[89]

The ALJ concluded the Facebook posts constituted protected and concerted activity under the Act because the employees were "taking a first step towards taking group action to defend themselves against [the other employee's accusations]."[90] The ALJ then applied the *Atlantic Steel* balancing test, finding the employees did not engage in any conduct that would cause them to lose the protection of the Act.[91] Because employees have a protected right to discuss matters affecting their employment amongst themselves, HUB's termination of the employees for such conduct was unlawful under section 8(a)(1).[92]

3. Wal-Mart

In contrast, the General Counsel concluded that an employee's profane Facebook comments that were critical of management were not protected where they appeared to be an expression of an individual gripe.[93] After a dispute with the manager, the employee posted on Facebook "Wuck Falmart" and complaints about "tyranny" at the store.[94] Two coworkers commented on the post expressing concern, leading the employee to respond "[my manager] is being a super mega puta" and "walmart can kiss my royal white ass."[95] The Board felt the employee's rant was akin to mere griping and not concerted because (1) it "contained no language suggesting that the employee sought to initiate or induce coworkers to engage in group action," and (2) the coworkers' Facebook responses did not indicate that they viewed the comments in any other way.[96] *Wal-Mart* illustrates the difficulty and ensuing confusion in applying the decades-old labor law to social media cases: despite obvious factual similarities to *Hispanics United* and *American Medical*, the employee in *Wal-Mart* did not receive the protection of the NLRA.

4. Karl Knauz Motors, Inc.

In *Karl Knauz Motors*, "a [NLRB ALJ] ruled, for the first time, that an employer could [lawfully terminate] an employee based on Facebook activity."[97] Here, a salesman for a luxury-car dealership posted photographs and commentary on his Facebook page criticizing a sales event at which the dealership served "over cooked weiner[s] and [] stale bun[s]."[98] Both before and during the event, employees at the dealership discussed their concern that the quality of the food would send a bad message to customers and inhibit their ability to make sales and earn commissions.[99] On the same day, the salesman posted pictures of an accident at a neighboring dealership also owned by his employer.[100] The ALJ found that although the postings involving the sales event and subsequent responses constituted protected activities, the postings involving the accident did not.[101] The employer did not have a social media policy, but it maintained the following work rule: "No one should be disrespectful or use profanity or any other language which injures the image or reputation of the Dealership."[102] The ALJ found that this provision was overly broad and tended to chill employee rights to discuss terms and conditions of employment.[103] The dealership's lawyer criticized the ruling as adding to the confusion, noting that it failed to "give[] any direction to an employer as to how they go about disciplining an employee or not" based upon a social media posting.[104]

II. Analysis

The NLRB's broad application of traditional labor doctrines to social media cases draws arbitrary distinctions that will lead to inconsistency and unpredictability. The Board's approach fails to provide specific guidance and will likely lead to future difficulties for both employers and employees. For instance, how is one to distinguish the protected criticism in *Hispanics United* from the unprotected griping in *Wal-Mart*? The NLRB's approach may suggest that the employee's individual rant in *Wal-Mart* would have received protection if coworkers had shown an interest in, or if another employee had chimed in, to the gripe-fest.[105] Similarly, in *American Medical*, the employee's derogatory remarks about her supervisor are hardly distinguishable from *Wal-Mart*, where the statements evidenced the mere lashing out by, and insubordination of, a single employee based solely on her own opinion.[106] Further, as in *Wal-Mart*, the coworker's responses in *American Medical* were merely supportive rather than indicative of group action.[107] The Board is walking a fine line by distinguishing between unprotected griping and protected group workplace criticism, and it has been said that "[t]oday's protected activity is tomorrow's unprotected employee rant, and vice versa."[108]

The crucial issue is the precise manner in which actions of an individual employee must be linked to the actions of fellow employees in order to constitute concerted activities.[109] Because an essential component of concerted activity is its collective nature, one can see how the analysis becomes particularly difficult in the context of social media, where a single employee's inherently "individual" statements are shared with an unlimited network of contacts—including coworkers. For instance, if an employee posts a message on Facebook and no one responds, can that message be deemed concerted? Does an individual gripe become concerted if it is related to a shared group concern or if other employees decide to join the gripe-fest? Are postings made from workplace computers more likely to be protected?[110] Is not every Facebook post concerted if the idea is to share one's thoughts with the public? As social networking sites continue to blur the line between individual and concerted activities—and between work and play—the courts and the Board must reevaluate what limitations should be placed on employee communication rights in the public forum.

This Part will discuss the shortcomings of the Board's current application of the law as well as the problems that it causes for employers and employees. Because courts and the Board often inconsistently interpret section 7, and given the widespread use of social media by employees, Part II.E suggests that a workable solution to the problem would be (1) for Congress to amend the NLRA[111] and (2) for courts and the Board to adopt a new multi-step approach for concertedness when an employee chooses to air his or her employment concerns through social media.[112]

A. The "Logical Outgrowth" Test Should Be Rejected as Legal Fiction

The logical outgrowth analysis should be rejected as an "unwarranted expansion of the definition of concerted action unsupported by statutory basis."[113] Under this standard, the Board protects individual activities that are the "logical outgrowth of concerns expressed by a group of employees."[114] Thus, by definition, an employee could post a gripe on Facebook with impunity so long as other workers may have an interest in the gripe. This expansive view of concerted activity poses an unreasonable threat to employers, runs contrary to the statutory scheme, and should be rejected as contrary to the standard set forth in *Meyers*.

The logical outgrowth analysis represents the very "legal fiction" of the constructive concert theory that the Board intended to eliminate in its *Meyers* decision[115] and that was explicitly rejected by appellate courts.[116] Further, it is an "effective[] resurrect[ion] [of] the *Alleluia* presumption that individual actions regarding 'group concerns' are concerted."[117] Substituting a presumption of concerted activity "for evidence of employees' actual behavior in the workplace contributes little to realistic analysis and…[s]uch a role [for the NLRB] is not contemplated by the statute."[118] Finally, "[a]lthough…the Supreme Court [has] rejected a literal reading of section 7, the Court did not authorize an interpretation that effectively deletes the word 'concerted' altogether."[119]

B. The Board Misapplied Longstanding Legal Doctrines

1. *Jefferson Standard* Should Be Interpreted to Prohibit Employee Rants on Social Media

In the General Counsel's report, the NLRB extends protection to several social media posts bordering on insubordination or disloyalty to the company[120]—reflecting an inadequate application of *Jefferson Standard*. The Board's analysis in *American Medical* reflects a misapplication of the *Jefferson Standard* doctrine and the well-established view that "nothing in the Act prevents an employer from disciplining or discharging an employee for disloyalty."[121] Under the first prong—communication must be related to an ongoing labor dispute—the employee's Facebook comments referring to the supervisor as a "dick" and a "scumbag"[122] clearly do not reflect on an ongoing dispute between the employees and the company, but rather her individual frustrations. Under the second prong—so disloyal as to lose the Act's protection—the employee's attack on the supervisor's competence (i.e., using the company's term for a psychiatric patient to refer to her supervisor) should be found as "a sharp, public, disparaging attack []on the quality of the company's product and its business policies."[123]

In *Endicott Interconnect Technologies, Inc.*, the D.C. Circuit held that an employee's statements on a newspaper's website—that one of the owners lacked the ability to manage the company and was going to "put it into the dirt"—were "unquestionably detrimentally disloyal" so as to lose the protection of the Act under *Jefferson Standard*.[124] Just like the Board in *Endicott*, the Board in *American Medical* "seemingly ignored the very attribute that justified discharging the technicians in *Jefferson Standard* for cause: the 'detrimental disloyalty' of [the employee's] assault on [her] employer."[125]

It is widely recognized that not all employee activity that prejudices the employer or could be characterized as disloyal will lose the protection of the Act.[126] Instead, the Board has held that protection "depends on whether the employees' actions appeared necessary to effectuate the employees' lawful aims."[127] It is difficult to imagine a scenario in which disparaging one's employer in a public forum could be deemed "necessary" to secure an employment-related benefit.[128] Further, in *American Medical* and similar social media cases, even if the employee's ultimate purpose—to secure an employment-related benefit—was lawful, "that purpose…was undisclosed."[129] Instead, the employee's statements reflect a disloyal and insubordinate act of a single employee based solely on her own opinion.[130] Thus, the Board should find that when an employee turns to social media to air disparaging views about an employer, "the means used by [the employee] in conducting the attack [] deprive[] the [attacker] of the protection of [section 7], when read in the light and context of the purpose of the Act."[131]

2. The *Atlantic Steel* Factors Should Weigh Against Protection in Social Media Rants

The NLRB misapplied the first and third factors of the *Atlantic Steel* balancing test to the social media cases. The first prong—place of discussion—traditionally weighs in favor of protection when the activity occurs outside the workplace and during nonworking time.[132] Consistent with this, the Board found Facebook postings to generally weigh in favor of protection because they occurred outside the workplace and "did not interrupt the work of any employee."[133] The nature of social media, however, demands a reevaluation of the place-of-discussion factor.

It is well established that the place of the discussion weighs against protection when the outburst occurs in the presence of employees and might affect workplace discipline.[134] The Board fails to take into account the effect offensive or disloyal comments may have on workplace discipline when they are broadcast over social media and inevitably seen by coworkers. Like similar cases regarding an employee's outburst in the presence of coworkers, an employee's disparaging remarks on Facebook "could be [seen] by coworkers and would reasonably tend to affect workplace discipline by undermining the authority of supervisors."[135] For instance, in *American Medical*, the employee made malicious remarks about her supervisor on Facebook that coworkers saw and commented on.[136] In such a case, where the supervisor is publicly vilified, the Board cannot simply ignore the negative effect such activity might have on workplace discipline.[137] Thus, rather than merely focusing on the physical location of the activity, in considering a social media outburst courts and the Board must also take into account the potential detrimental effect on workplace discipline and the employer's interest in maintaining decorum. Historically, this factor weighs against protection when the outburst is overheard by other employees, and the whole idea of social media is to air one's thoughts to the public.[138] However, the Board seemingly ignored this factor, basing its conclusion on the idea that Facebook comments occurred "outside the workplace."[139]

The Board also misapplied the third prong of *Atlantic Steel*—the nature of the employee's outburst. In analyzing the employee's profane Facebook comments about her supervisor in *American Medical*, the Board concluded that (1) they were “not accompanied by verbal or physical threats, and (2) the Board has found more egregious name-calling protected.”[140] First, in 2002 the D.C. Circuit rejected a similar Board rationale, stating “[t]hat no threat or physical violence accompanied [the] insubordinate vitriol cannot, under established law, prevent it from weigh[ing] in favor of…losing the protection of the Act.”[141] The court ultimately held that the nature of the outburst will weigh against protection where the employee “denounc[es] a supervisor in obscene, personally-denigrating, or insubordinate terms.”[142] Second, the justification that the Board has protected more egregious outbursts in the past is equally flawed. In analyzing the nature of the outburst, it has long been held that the inquiry focuses on the degree of language that is common and tolerated in the workplace,[143] rather than on what the Board has generally held tolerable in the past.

Thus, when an employee airs an offensive grievance via social media, *Atlantic Steel* and its progeny necessitate a consideration of the public nature of social media outbursts, and the nature of the outburst must be considered in the context of the specific employee’s work environment.

C. Case Law in Similar Areas Finds an Implied Duty of Loyalty

The NLRB’s position will probably be tested against case law in similar areas interpreting what employees can be fired for when they are not on the job.[144] For instance, some legal commentators analogize recent social media cases to *Marsh v. Delta Airlines*, a 1997 pre-Internet case in which a baggage handler for Delta Airlines was terminated after writing a letter to the editor of the *Denver Post* criticizing the company.[145] In that case, Mr. Marsh, an employee of more than 26 years, sued, claiming that his termination was a violation of a Colorado lifestyle statute prohibiting termination based on legal activities taking place off-premises during nonworking hours.[146] Delta argued that it was justified in terminating Marsh under an exception to the statute permitting termination where the employee was engaged in an activity “related to a bona fide occupational requirement.”[147] The district court sided with the employer, finding an “implied duty of loyalty, with regard to public communications, that employees owe to their employers.”[148] Finding that Marsh violated this implied duty of loyalty by publicly disparaging Delta, the court found that Delta was justified in its discharge.[149] Thus, in dealing with increased social media presence, it is possible that courts will infer an implied duty of loyalty that employees owe to their employers with regard to public communications.

D. The Board’s Position on Social Media Policies: A Misguided Approach

The increasing use of social media to discuss the workplace is leading many employers to re-examine and in some cases develop a social media policy. Despite employers’ attempts to protect themselves, the NLRB is targeting many of these provisions prohibiting harassment or offensive communication in its “increasingly aggressive stance” towards social media in the workplace.[150]

From the social media policies the NLRB has found to be overbroad, unlawful provisions generally failed to include sufficient limiting language from which an employee could conclude that they did not apply to section 7 protected activity.[151] Under the NLRB’s latest approach an employer cannot maintain a policy that generally prohibits employees from discussing the company, its employees, or competitors through social media.[152] This position conflicts with recent Board decisions and well-established case law regarding similar policies.

1. The NLRB Is Exhibiting Conflicting Stances

The NLRB’s position on social media policies has created confusion for both employers and employees, as it is seemingly at odds with its decision from 2009 in *Sears Holdings*.[153] The social media policy examined in *Sears Holdings* was substantially similar to the policy in *American Medical*, with the portion at issue prohibiting “disparagement of [the] company’s or competitors’ products, services, executive leadership, [and other] employees.”[154] The Board’s long-held emphasis on a “reasonable reading” of the rule—cautioning against “reading particular phrases in isolation”[155]—prevented it from scrutinizing the word “disparagement” in Sears’ policy.[156] Relying on the *Lutheran Heritage* test, the Board found that the policy as a whole provided sufficient context to preclude a reasonable employee from construing the rule unlawfully.[157]

Legal commentators note that minor variations in Sears’ policy and those examined in the recent Advice Memorandum do not justify contrary results.[158] It has been further stated that in applying longstanding and complex legal standards to a new factual context, the NLRB is showing a lower tolerance than before for certain actions by employers and attempting to expand the scope of protected concerted activity.[159]

2. The NLRB’s Position Is Contrary to Case Law

The NLRB’s recent position stands in “stark contrast” to case law evaluating similarly worded employer policies that have arisen in similar areas.[160] In 2001 in *Adtranz*, the D.C. Circuit examined an employer’s policy prohibiting the use of “abusive or threatening language to anyone on company premises.”[161] The *Adtranz* court held the rule was lawful because it was clearly intended to maintain a civil and decent workplace and to avoid employer liability, vacating the NLRB’s determination that the policy had the potential to chill the exercise of protected activity.[162] In fact, the court noted, “the Board’s position that the imposition of a broad prophylactic rule against abusive and threatening language is unlawful on its face is *simply preposterous*.”[163] The court also attacked the Board’s “remarkabl[e] indifferen[ce] to the concerns and sensitivity which prompt many employers to adopt [similar rules]," adding, "[a]ny reasonably cautious employer would consider adopting [such a rule]."[164] For employers, "the only reliable protection is a zero-tolerance policy…and to bar, or severely limit an employer's ability to insulate itself from such liability is to place it in a 'catch 22.'"[165]

Two years later in *Community Hospitals*, the D.C. Circuit again upheld an employer policy that prohibited "insubordination…or other disrespectful conduct towards a supervisor or other individual."[166] The provision is markedly similar to the social media policy found unlawfully overbroad in *Knauz BMW*: "No one should be disrespectful or use profanity or any other language which injures the image or reputation of the Dealership."[167] Although the NLRB found that the term "disrespectful conduct" could be construed to include section 7 activity—as the ALJ did in *Knauz BMW*[168]—the appellate court found the rule "clearly" did not do so when read in context.[169] The court concluded "any arguable ambiguity in the rule arises only through…attributing to the employer an intent to interfere with employee rights."[170] Thus, it is clear that the NLRB is taking a materially different approach to that of the D.C. Circuit regarding the analysis of similarly worded policies, while deviating from the long-held emphasis on a "reasonable reading" of the rule.[171]

E. Proposed Solution

Social media increasingly blurs the boundaries between public and private, and business and personal. Further, as employees become more comfortable and informal with their public postings and shared information, employers are becoming more vulnerable. The Board's current application of outdated labor laws to the modern workplace is misguided, inconsistent, and provides little guidance to employers and employees in avoiding liability.

First, Congress should amend the NLRA to reflect longstanding case law by expressly authorizing some individual activities under section 7 and codifying a disloyalty exception based on *Atlantic Steel* and *Jefferson Standard*. Second, courts and the Board should adopt a heightened concertedness standard for social media: (1) the statement must be directed to one or more coworkers, and (2) the statement must reveal intent to spur group action. This unified standard for social media postings will provide consistency and predictability, giving due regard to the increased vulnerability of employers when an employee takes to the Internet to air work-related grievances.

1. Congress Should Amend the NLRA

Congress should amend section 7 of the Act to define the scope of concerted activity and expressly reflect: (1) the protections given to some individual activities under section 7 and (2) the fact that one may lose the protection of the Act through one of various disloyalty exceptions. Congressional clarification in these areas would provide stability and predictability in the law for courts, the Board, employers, and employees.

The literal language of the NLRA protects those employees who act in concert; currently, it says nothing about protecting those who act alone.[172] However, courts and the Board consistently acknowledge that *some* type of individual conduct is protected by section 7.[173] Explicit protection of individual concertedness would reduce uncertainty, help eliminate wavering interpretations of section 7, and merely codify longstanding case law holding the same.

It is well-established that an employee may lose the Act's protection through disloyal or opprobrious conduct.[174] Using these longstanding doctrines and case law in similar areas such as *Marsh v. Delta*, Congress should amend the NLRA to codify a disloyalty exception. While it may be impossible to completely eliminate the subjectivity of the *Atlantic Steel* and *Jefferson Standard* balancing tests, a disloyalty exception codified in the NLRA may serve as a check on the discretion of courts and the Board. Further, such legislative articulation of a limitation on NLRA protection may serve to hold employees more accountable for their actions.

2. Multi-Step Test for Concerted Protected Activities in Social Media

First, the activity must be protected. Facebook posts, like traditional section 7 activities, will be protected when they relate to the terms and conditions of employment. However, the Supreme Court has noted that "at some point the relationship [between a concerted activity and employees' interest as employees] becomes so attenuated that an activity cannot fairly be deemed to come within the mutual aid or protection clause."[175] Thus, in evaluating a social media posting, the law should require that the content of the post have a *substantial* connection to concrete employment interests in order to be protected.

Second, courts and the Board should adopt a two-part test for concerted activities in the context of social media. Under this new standard, an individual's Facebook post will constitute concerted action when (1) it is directed to one or more coworkers and (2) the statement reveals intent to spur group action. First, because of the inherently individual nature of social media, the law should require that public comments be directed to one or more coworkers to ensure that the activity is genuinely concerted. This requirement is consistent with the Supreme Court's emphasis that "it is protection for *joint* employee action that lies at the heart of the Act."[176] This step can be satisfied by referencing another coworker in a public posting, but its aim is to incentivize the use of private messaging features or private "groups" on Facebook to discuss work issues. Second, the law should require that the public posting reveal intent to spur group action. This is consistent with the Third Circuit's ruling in *Mushroom Transportation*—that a conversation between employees must seek to initiate or induce group action to be protected. This will eliminate arbitrary distinctions where an employee's individual gripe over social media could be found concerted merely because (1) a fellow coworker chimes in or (2) other coworkers share a similar concern.

3. Balancing Employer and Employee Interests

This heightened multi-step approach will strike the optimal balance between the competing interests of employers and employees. It is in their mutual interest to achieve certainty and predictability in the law, as well as the free flow of useful information. Employers want to maintain a civil and productive workplace, protect their online reputation, and ensure that other employees are not harassed on social networking sites. This higher standard will satisfy these interests by holding employees more accountable for their actions. More importantly, it can do so without hampering the effectiveness of communication or interfering with true collective bargaining rights. Employees will continue to benefit from the quick, informal, and efficient aspects of social media when used in the context of what section 7 of the NLRA was meant to protect—discussing workplace conditions among employees.[177] The two-part test would incentivize employees to limit public access to their work-related statements in order to receive the most protection. Thus, employees would be encouraged to turn to private messages, forums, or private employee blogs, rather than broadcast work complaints to an unlimited number of contacts and thereby needlessly tarnish the employer's image. This guarantee of protection in a more private forum might spark more honest dialogue, as employees will likely be more willing to speak freely without fear of discipline.

III. Conclusion

While social media is a valuable communications tool, its widespread use by employees to discuss the workplace has raised significant and complex issues in the context of labor law. The NLRB's current application of the seventy-five-year-old NLRA to the modern workplace is misguided, inconsistent, and provides little guidance to employers and employees in avoiding liability. The changing environment of employee communication necessitates a reevaluation of traditional labor law principles.

In order to reflect well-established case law, Congress should clarify some of the ambiguity surrounding concertedness by amending section 7 of the NLRA to authorize the protection of individual activities. Further, section 7 should be amended to reflect longstanding case law providing for disloyalty exceptions to NLRA protection.

The nature of social media demands a distinct and heightened standard for concertedness. First, the content of the post must have a *substantial* connection to concrete employment interests in order to be protected. Second, a social media post must be (1) directed to one or more coworkers and (2) reveal intent to spur group action. This unified two-step test will provide predictability for employers and employees, eliminate arbitrary distinctions by ensuring that social media activity is genuinely concerted, and strike the optimal balance between the competing interests of employers and employees.

While analyzing the protections of the NLRA in the realm of social media involves many uncertainties, one thing is certain: employers must be particularly cautious and pay close attention to the development of traditional labor law by courts and the NLRB as they attempt to deal with the technological realities of how employees communicate in the age of virtual communication.

Endnotes

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51. *Id.* at 476.

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58. *Id.* at 647.

59. See *id.* at 647, refusing to find a violation "whenever the rule could conceivably be read to cover Section 7 activity…."

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78. *Id.*

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80. *Id. See also* NLRB O-M Memorandum 11-74, *supra* note 39, at 4. But see Trus Joist MacMillan, 341 N.L.R.B. 369, 371 (2004), finding no protection for an "offensive outburst [that] was not a spontaneous or reflexive reaction…." See Care Initiatives, Inc., 321 N.L.R.B. 144, 151 (1996) (alteration in original) (quoting Caterpillar Tractor Co., 276 NLRB 1323, 1326 (1985)), explaining that even when they occur during an otherwise protected activity, "'insulting, obscene personal attacks [by an employee against a supervisor] need not be tolerated." Media General Operations, Inc. v. NLRB, 560 F.3d 181, 189 (4th Cir. 2008) (holding that an employee's use of profane and offensive language during labor negotiations forfeited protection of the NLRA).

81. NLRB O-M Memorandum 11-74, *supra* note 39, at 4 ("For example, an employee could not post a picture of employees carrying a picket sign depicting the company's name….").

82. *Settlement Reached in Case Involving Discharge for Facebook Comments*, NLRB (Feb. 8, 2011), *available at* http://www.nlrb.gov/news/settlement-reached-case-involving-discharge-facebook-comments.

83. Christopher A. D'Angelo, *Employees and Social Media*, *in* Social Media 2011: Addressing Corporate Risks, 1034 PLI/Pat 129, 136 (PLI Intellectual Prop., Course Handbook Ser. No. 30703, 2011).

84. Foulston Siefkin LLP, *Drafting Social Media Policies that Won't Land You on Twitter*, 18 No. 5 Kan. Emp. L. Letter 5 (August 2011).

85. Patricia Nemeth & Erin Behler, *Recent Flurry of NLRB Complaints Puts Focus on Evolving Social Media Disciplinary Issues*, Law.com (Oct. 10, 2011), http://www.law.com/jsp/article.jsp?id=1202518321075&slreturn=1; Hispanics United of Buffalo, Inc., No. 3-CA-27872, 2011 WL 3894520 (N.L.R.B. Div. of Judges Sept. 2, 2011).

86. *Hispanics United of Buffalo, Inc.*, 2011 WL 3894520.

87. *Id.*

88. *See id.*; Randy Avram & Michael Rosenberg, *Social = Concerted*, Corporate Counsel (Nov. 1, 2011), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202518252166.

89. *Hispanics United of Buffalo, Inc.*, 2011 WL 3894520.

90. *Id.*

91. *See id.* (finding it significant that the posts were made neither at work nor during working hours, were related to protected activity, and did not involve any "outbursts").

92. *Id.*

93. *See* NLRB O-M Memorandum 11-74, *supra* note 39, at 16 (finding insufficient evidence of concerted activity).

94. *Id.* (discussing the facts of the case); Shilling, *supra* note 79.

95. NLRB O-M Memorandum 11-74, *supra* note 39, at 16 (discussing the facts of the case); Shilling, *supra* note 79.

96. NLRB O-M Memorandum 11-74, *supra* note 39, at 16–17.

97. Karl Knauz Motors, Inc., No. 13-CA-46452, 2011 WL 4499437 (N.L.R.B. Div. of Judges Sept. 28, 2011); Eric B. Meyer, *Pyrrhic Victory: Judge Ok's Firing for Facebook Post, But…*, The Emp'r Handbook (Oct. 3, 2011, 7:00 AM), http://www.theemployerhandbook.com/2011/10/nlrb-delivers-a-pyrrhic-facebo.html.

98. *Karl Knauz Motors, Inc.*, 2011 WL 4499437.

99. Ameet Sachdev, *Judge Backs Car Dealer That Fired Employee Over Facebook Post*, Chi. Trib. (Oct. 1, 2011), *available at* http://articles.chicagotribune.com/2011-10-01/business/ct-biz-1001-nlrb-20111001_1_facebook-post-karl-knauz-bmw-dealership.

100. *Id.*

101. *Karl Knauz Motors, Inc.*, 2011 WL 4499437.

102. *Id.*

103. *Id.*

104. Judy Greenwald, *NLRB Upholds Car Dealership Worker's Firing Over Facebook Post*, Workforce, Oct. 4, 2011, http://www.workforce.com/article/20111004/NEWS01/111009986/nlrb-upholds-car-dealership-workers-firing-over-facebook-post#.

105. *Compare* Hispanics United of Buffalo, Inc., No. 3-CA-27872, 2011 WL 3894520 (ALJ Sept. 2, 2011) (finding protected workplace discussion where coworkers joined in making comments critical of management), *with* NLRB O-M Memorandum 11-74, *supra* note 39, at 15 (finding no protection where coworkers's comments reflected mere concern rather than collective sentiment).

106. *Compare* NLRB O-M Memorandum 11-74, *supra* note 39, at 3 (finding protection in *Atlantic Steel* where employee referred to her supervisor as a "scumbag" and a "dick"), *with* NLRB O-M Memorandum 11-74, *supra* note 39, at 15 (finding no protection where employee referred to his manager as a "super mega puta").

107. *Compare* NLRB O-M Memorandum 11-74, *supra* note 39, at 3 (finding protected group discussion where the employee's Facebook post "drew supportive responses from her coworkers"), *with* NLRB O-M Memorandum 11-74, *supra* note 39, at 16 (finding evidence of an individual gripe where coworkers' responses "offered emotional support").

108. Jon Hyman, *Workplace Social Media Becomes a Federal Issue, Says U.S. Chamber Survey*, Ohio Emp'r's Law Blog (Aug. 8, 2011), http://www.ohioemployerlawblog.com/2011/08/workplace-social-media-becomes-federal.html#.Tq3OR3MW_zU.

109. NLRB v. City Disposal Sys. Inc., 465 U.S. 822, 830–31 (1984).

110. Melanie Trottman, *For Angry Employees, Legal Cover for Rants*, Wall St. J. (Dec. 2, 2011), http://online.wsj.com/article/SB10001424052970203710704577049822809710332.html. The Board has not faced such a case. *Id.*

111. *See infra* discussion Part II.E.

112. *See infra* discussion Part II.E.

113. NLRB v. Bighorn Beverage, 614 F.2d 1238, 1242 (9th Cir. 1980).

114. Five Star Transp., Inc., 349 N.L.R.B. 42, 58 (2007).

115. Salisbury Hotel, 283 N.L.R.B. 685, 688 (1987) (Chairman Dotson, concurring); *see* Meyers Indus., 268 N.L.R.B. 73 (1984) (overturning *Alleluia Cushion*).

116. *See supra* notes 33–35 and accompanying text.

117. Salisbury Hotel, 283 N.L.R.B. at 688.

118. Every Woman's Place, 282 N.L.R.B. 413, 415 (1986) (Chairman Dotson, dissenting); *see also* Terry A. Bethel, *Constructive Concerted Activity Under the NLRA: Conflicting Signals from the Court and the Board*, 59 Ind. L.J. 583, 631 (1983) ("By creating concert where none exists, or worse, by reading the requirement out of the Act altogether, one can overcome the impediment to Board jurisdiction and allow that agency to assess the wisdom of employer action under the guise of protecting employees' right to organize.").

119. B. Glenn George, *Divided We Stand: Concerted Activity and the Maturing of the NLRA*, 56 Geo. Wash. L. Rev. 509, 528 (1988).

120. *See supra* notes 71–92 and accompanying text.

121. George A. Hormel & Co. v. NLRB, 962 F. 2d 1061, 1064 (D.C. Cir. 1992).

122. Michael J. Eastman, *A Survey of Social Media Issues Before the NLRB*, U.S. Chamber of Commerce, at 22.

123. *Jefferson Standard*, 346 U.S. 464, 471 (1953).

124. Endicott Interconnect Tech., Inc. v. NLRB, 453 F.3d 532, 537 (D.C. Cir. 2006).

125. *Id.*

126. Five Star Transp., Inc. v. NLRB, 522 F.3d 46, 53–54 (1st Cir. 2008).

127. *Id.* at 54 (quoting NLRB v. Mount Desert Island Hosp., 695 F.2d 634, 640 (1st Cir. 1982) (internal quotation marks omitted)).

128. For example, in *Jefferson Standard* the employees' public distribution of handbills criticizing the employer showed a disloyalty to the employer which the Court deemed unnecessary to carry out the employees' legitimate concerted activities. NLRB v. Washington Aluminum Co., 370 U.S. 9, 17 (1962) (distinguishing Jefferson Standard, 346 U.S. 464 (1953)).

129. *Int'l Bhd. Elec. Workers*, 346 U.S. at 472.

130. *See id.* at 475 (finding adequate cause for discharge for "insubordination, disobedience or disloyalty").

131. *See Jefferson Standard*, 346 U.S. at 477–78 (1953) ("Nothing would contribute less to the Act's declared purpose of promoting industrial peace and stability."). See also *In re* Am. Golf Corp., 330 N.L.R.B. 1238, 1241 (2000), finding that the employee's flyer made no reference to a labor controversy and made a "sharp, public, disparaging attack upon the quality of the company's product and business policies."

132. *See Noble Metal Processing*, 346 N.L.R.B. 795, 800 (2006) (finding the place of discussion to weigh in favor of protection where the outburst occurred away from employees' work area and did not disrupt the work process).

133. Office of General Counsel, NLRB, Memorandum O-M 11–74, "Report of the Acting General Counsel Concerning Social Media Cases," Aug. 18, 2011.

134. *See In re Aluminum Co. of Am.*, 338 N.L.R.B. 20, 22 (2002) (finding employee's outburst in an employee break room weighed against protection because it could be overheard by coworkers and would reasonably tend to affect workplace discipline); Trus Joist Macmillan, 341 N.L.R.B. 369, 370 (2004) (finding an outburst in the manager's office to have a less disruptive effect than it would have if it had occurred on the plant floor in the presence of employees).

135. *In re Aluminum Co. of Am.*, 338 N.L.R.B. at 22.

136. *See* Eastman, *supra* note 74, at 22 (referring to her supervisor as a "dick" and a "scumbag").

137. *See In re Aluminum Co. of Am.*, 338 N.L.R.B. at 22 (finding employee's outburst in an employee break room weighed against protection because it could be overheard by coworkers and would reasonably tend to affect workplace discipline).

138. *See supra* notes 7–19 and accompanying text (discussing the impact of social media).

139. Office of General Counsel, *supra* note 133, at 3–4.

140. *Id.* at 4. See also *id.* at 7, noting in *Karl Knauz BMW* that "the nature of the outburst was much less offensive than other behavior found protected by the Board."

141. *Felix Industries, Inc. v. NLRB*, 251 F.3d 1051, 1054–55 (D.C. Cir. 2001).

142. See *id.* at 1055 (quoting *Aroostook County v. NLRB*, 81 F.3d 209, 215 n. 5 (D.C. Cir. 1996)), adding that the court previously rejected the notion that "employees engaging in protected activity 'could not be dismissed unless they were involved in flagrant, violent, or extreme behavior….'"

143. *See In re Aluminum Co. of Am.*, 338 N.L.R.B. 20, 22 (2002) ("The employee's profanity far exceeded that which was common and tolerated in his workplace."). See also Atlantic Steel Co., 245 N.L.R.B. 814, 819 (1979), noting that the exception could hardly apply "[i]n a plant where obscenity and profanity of speech are commonplace…."

144. Elzweig & Peeples, *supra* note 73.

145. *Id.*; *see also* Kerry M. Lavelle, *Why Every Employer Should Adopt A Social Media Networking Policy*, Construction Equipment Distrubtion (Sept. 1, 2010), http://www.cedmag.com/article-detail.cfm?id=10926323 (discussing off-duty conduct statutes that may limit employer's ability to terminate employees); Marsh v. Delta Air Lines, Inc., 952 F.Supp. 1458, 1460 (D. Colo. 1997) (finding an implied duty of loyalty).

146. *Marsh*, 952 F.Supp. at 1461.

147. *Id.*

148. *Id.* at 1463.

149. *Id.* at 1464.

150. Jeffrey S. Klein & Nicholas J. Pappas, *Do Social Media Policies Violate NLRA Section 7 Rights?*, Law Tech. News (Oct. 11, 2011), http://www.law.com/jsp/lawtechnologynews/PubArticleLTN.jsp?id=1202518441906&Do_Social_Media_Policies_Violate_NLRA_Section_7_Rights.

151. Nathan L. Kaitz, *Social Media Policies Can Run Afoul of the National Labor Relations Act*, Morgan, Brown & Joy LLP, http://www.morganbrown.com/legal/legal_update.php?id=237.

152. *See, e.g.*, *supra* notes 75–84, 102–03 and accompanying text.

153. *See* Michael J. McNamara, *The Times Are Changing: Protecting Employers in Today's Evolving Workplace*, Employment Law 2011: Top Lawyers on Trends and Key Strategies for the Upcoming Year, Feb. 2011, at 5, *available at* 2011 WL 601173 (addressing the NLRB's conflicting positions).

154. Office of General Counsel, NLRB, Advice Memorandum, Sears Holdings Case 18–CA–19081, Dec. 4, 2009.

155. See Martin Luther Memorial Home Inc. (Lutheran Heritage), 343 N.L.R.B. 646, 647 (2004), refusing to find a violation "whenever the rule could conceivably be read to cover Section 7 activity…."

156. Office of General Counsel, *supra* note 154, at 4.

157. *Id.*

158. Cameron G. Shilling, *United States: Social Media and the NLRB (Part 1): The NLRB Intervenes in Social Media*, McLane Blog (Oct. 3, 2011). http://blog.mclane.com/?p=618http://blog.mclane.com/?p=618.

159. Zascha Blanco Abbott, *NLRB Changes Impacting Union and Non-union Employers*, Employment Law 2011: http://www.dri.org/articles/Employment/FTD-1106-Abbott.pdf; *see also* Cameron G. Shilling, *Social Media and the NLRB (Part 3): Discipline and Discharge – The Breadth of Concerted Activity*, McLane Blog (Oct. 7, 2011) ("The protections given to [social media-related] conduct as concerted activity are broader than typically anticipated."); *US: NLRB's Report on Employers' Social Media Policies "Too Protective*," Data Guidance (Sep. 15, 2011), http://www.dataguidance.com/news_1010.asp?id=1604 (suggesting an employee-friendly application of the law). It has been widely suggested that the shift in opinion may be related to the composition of the Board, noting a strongly pro-labor Board under the Obama administration, in contrast to the pro-employer Republican majority in 2009. Michael J. McNamara, *The Times Are Changing: Protecting Employers in Today's Evolving Workplace*, *in* Employment Law 2011: Top Lawyers on Trends and Key Strategies for the Upcoming Year (Feb. 2011), at 5, *available at* 2011 WL 601173.

160. Jeffrey S. Klein & Nicholas J. Pappas, *Do Social Media Policies Violate NLRA Section 7 Rights?*, Law Technology News (Oct. 11, 2011), http://www.law.com/jsp/lawtechnologynews/PubArticleLTN.jsp?id=1202518441906&Do_Social_Media_Policies_Violate_NLRA_Section_7_Rights.

161. Adtranz ABB Daimler-Benz Transp., N.A. Inc. v. NLRB, 253 F.3d 19, 25(D.C. Cir. 2001).

162. *See id.* at 25.

163. *See id.* at 28 (emphasis added).

164. *See id.* at 27.

165. *See id.*

166. Cmty. Hosps. of Cent. Cal. v. NLRB, 335 F.3d 1079, 1088–89 (D.C. Cir. 2003).

167. Karl Knauz Motors, Inc., No. 13-CA-46452, 2011 WL 449943 (ALJ Sept. 28, 2011).

168. *Id.*

169. Cmty. Hosps. of Cent. Cal, 335 F.3d at 1088.

170. *Id.* at 1089.

171. Martin Luther Mem'l Home, Inc. (Lutheran Heritage), 343 N.L.R.B. 646, 647 (2004).

172. NLRB v. City Disposal Sys. Inc., 465 U.S. 822, 834 (1984).

173. Terry A. Bethel, *Constructive Concerted Activity Under the NLRA: Conflicting Signals from the Court and the Board*, 59 Ind. L.J. 583, 597 (1983).

174. *See supra* notes 46–52 and accompanying text.

175. Eastex, Inc. v. N.L.R.B., 437 U.S. 556, 567–68 (1978).

176. Meyers II, 281 N.L.R.B. 882, 883 (emphasis added). The Supreme Court has also noted that the policy of the Act is to "protect the right of workers to *act together* to better their working conditions." Eastex, Inc. v. N.L.R.B., 437 U.S. 556, 566 (1978) (emphasis added) (citing NLRB v. Washington Aluminum Co., 370 U.S. 9, 14 (1962)).

177. *See supra* notes 24–26 and accompanying text.

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Jumping the Gun: Social Media and IPO Communications Issues

By Dwight S. Yoo and Rakhi I. Patel

Increasingly, companies are using social media, such as Facebook, Twitter, YouTube and other platforms, to engage with clients, customers, employees, shareholders and other key constituents. Promising a fast and low-cost means of disseminating information, social media also offers the potential for even broader distribution through third-party word-of-mouth advocacy. However, when a company plans an IPO in the United States, social media's powerful benefits can pose significant risks.

To date, the SEC has not brought an action for violation of its IPO publicity restrictions involving social media; however, as corporate social media continues to proliferate, it is likely only a matter of time before the SEC acts. Companies preparing to go public need to understand the various SEC rules restricting communications during the IPO process. Instituting well-defined policies and procedures governing social media is critical to avoiding inadvertent violations and the penalties that can follow, which may potentially impact the IPO.

Gun-Jumping

"Gun-jumping" is an expression, not defined in the U.S. securities laws, that generally refers to a violation of U.S. securities law restrictions on issuer publicity and communications before, during or after a public offering. U.S. securities laws prohibit communications that improperly stimulate interest in the securities offered in an IPO. For an IPO, the restrictions start as early as the time the company reaches an understanding with the managing underwriter (potentially before the company even holds its IPO organizational meeting) and end 25 days after the pricing of the offering. Gun-jumping consequences can be serious and can include rescission, a cooling-off period delaying the IPO or sanctions / fines.

"Gun-jumping" restrictions are wide-reaching: They apply to all forms of communications and cover press releases, media interviews, website postings, emails, internal company announcements, Facebook posts, Twitter tweets, YouTube videos and online commentary. The often casual and spontaneous nature of social media communications, combined with the ability to disperse messages instantly and broadly, heightens the risk of inadvertent gun-jumping. Additionally, companies often subject social media communications to less stringent review than traditional print publications or press releases.

Given the broad application of "gun-jumping" restrictions, it is possible that the SEC could consider seemingly ordinary, noncontroversial communications as "gun-jumping." For example, if appropriate care is not taken, a significant increase in Internet advertising or a company website revamp immediately preceding an IPO could be viewed as "gun-jumping" if it is deemed to be stimulating interest in the IPO.

While a company is not responsible for third-party commentary posted on its social media platforms (including a company website), re-tweeting a third-party Twitter post could raise a red flag. The same holds true for repackaging posted commentary from third parties in company communications, particularly if the company is viewed as sponsoring or affirming the commentary.

Prominent Gun-Jumping Examples

While the following examples of gun-jumping did not involve corporate social media, they are instructive of the general risks and may point to areas in which future notable violations could occur through the use of interactive platforms.

- **Google.** In April 2004, approximately one week before Google Inc. filed its IPO registration statement with the SEC, the company's co-founders gave an interview to *Playboy* magazine. Four months later, the interview appeared in the magazine with the cover title "The Google Guys: America's Newest Billionaires." At the time, the media speculated that the SEC would impose a cooling-off period. While the SEC did not delay the much-anticipated IPO, in the face of SEC comments, Google included the text of the article as an appendix to the prospectus and, as a consequence, assumed prospectus liability for the article's contents. In doing so, Google (and its lawyers) proceeded with care: After careful review of the article's text, Google appended an addendum correcting what it believed were factual inaccuracies. The company also included a risk factor in the prospectus, which disclosed that, while Google "would contest vigorously any claim that a violation of the Securities Act occurred," the company could be subject to rescission claims if its involvement in the *Playboy* article were held by a court to violate the Securities Act.

- **Groupon.** In June 2011, Groupon, Inc. filed a registration statement with the SEC for its proposed IPO. The financial media and investment blogs were skeptical of Groupon's use of a non-GAAP accounting metric that made the company appear profitable. Groupon's business model also was questioned, as critics cited low barriers to entry into the industry and the potential of deep-pocketed competitors to the company. In August 2011, Groupon's CEO and co-founder sent an email to employees, which contained impassioned defenses of Groupon's business. The email leaked and quickly went viral. Because of SEC scrutiny and poor market conditions, Groupon's IPO was delayed for months. In addition, the SEC required Groupon to include the email as an appendix to the prospectus, and Groupon, like Google, assumed prospectus liability for the email's contents. Groupon also included a risk factor, which began, "In making an investment decision, you should not rely on an email sent by our Chief Executive Officer to certain employees that was leaked to the media without our knowledge."

SEC Actions in Other Areas Relating to Social Media Use

While the SEC has not yet brought an action for a gun-jumping violation involving social media, the SEC recently delivered a prominent notice to Netflix, Inc. and its founder and CEO, Reed Hastings, relating to a personal Facebook post under Regulation FD (an SEC rule adopted in 2000 that prohibits selective disclosure of material, nonpublic information and aims to promote full and fair disclosure).

- **Netflix.** In December 2012, Netflix received a Wells notice from the staff of the SEC indicating its intent to recommend that the SEC institute a cease-and-desist proceeding and / or bring a civil injunctive action against Netflix and Hastings for violations of Regulation FD and certain Securities Exchange Act provisions. The notice related to Hastings' post to a personal Facebook page with more than 200,000 subscribers that stated, in relevant part, that Netflix's monthly viewing exceeded 1 billion hours for the first time.[1] While the materiality of the statement may be debated,[2] the SEC action drew attention as it suggests that a Facebook post—even if distributed to more than 200,000 people and made available on a platform that anyone can access—still is not a recognized method under Regulation FD. Critics of the SEC's action noted that the Facebook posting likely reached more people and was read more immediately than would have been the case with an SEC filing. Critics also expressed surprise that the SEC took such a prominent stance on social media based on facts that, to some, seemed innocuous compared with violations alleged by the SEC in the past.

One takeaway from the Netflix case is clear: Communications on social media platforms are now a focus of the SEC. Accordingly, issuers preparing for an IPO should pay careful attention to their social media activities.

Brief Primer on the Gun-Jumping Rules[3]

Understanding the three distinct periods in which different SEC guidelines and restrictions apply may provide a practical framework for issuers in managing their social media use.

1. **Pre-Filing Period: No Offers (Not Even Oral Ones).** During the pre-filing period (after the company is "in registration" but before the registration statement is filed), no offer, whether oral or in writing, may be made under Section 5(c) of the Securities Act. Section 2 of the Securities Act defines "offer" as "every attempt or offer to dispose of, or solicitation of offers to buy, a security or interest in a security for value." Courts have given expansive interpretation to what constitutes an "offer," which includes any activity that creates a buying interest in an offered security. Most importantly, an issuer's intent is not required for a violation to be deemed to have occurred.

2. **Waiting Period: No Written Offers.** During the waiting period (after the registration statement is filed but before effectiveness), issuers may make oral offers, but written offers may only be made through a prospectus that complies with the Securities Act.

3. **Post-Effective Period.** Once the SEC declares an issuer's registration statement effective, the issuer must continue to comply with communications restrictions until the end of the prospectus delivery period (25 days after the pricing of the IPO). A prominent example of an issuer navigating this requirement is Facebook, which waited until day 26 to respond to questions on its business model.

Safe Harbors and Exceptions

Numerous "safe harbors" and SEC exceptions to the gun-jumping restrictions do exist (e.g., the JOBS Act allows "emerging growth companies" to test interest in a potential IPO with qualified institutional buyers and institutional accredited investors, Securities Act Rule 169 allows nonreporting issuers to continue regularly released business information excluding forward-looking statements, and Securities Act Rule 163A provides a safe harbor for certain communications made more than 30 days before the registration statement is filed).[4] In general, companies planning an IPO should keep the following rule of thumb in mind: the U.S. securities laws are not meant to disturb "business as usual" activities and communications. If the communication consists of factual business information and is consistent with past practice, it generally will not violate gun-jumping restrictions.

Managing Social Media During the IPO Process: A Practical Guide

Before starting the IPO process (or, with respect to certain employees who will not know about the IPO beforehand, immediately after the initial registration statement filing), companies should:

- Identify the group of specific individuals within the company who will be authorized to conduct or sign off on all social media communications. For example, even if a sales force regularly employs social media to pitch products, it is not unusual for companies planning an IPO to temporarily halt or more closely monitor the sales force's use of social media during the IPO process to institute a measure of control over communications.

- Establish a social media policy that clearly sets forth the company's expectations with respect to social media communications, and which includes a list of unambiguous "dos and don'ts." The policy, which should be disseminated to all employees and others who may act on the company's behalf, should state that responses to any inbound inquiries through social media platforms are restricted to the small group of identified individuals, and to whom any inbound inquiries should be directed.

- Provide training to ensure persons subject to the social media policy understand how to comply. If the CEO or CFO delivers the message, it will help ensure employees and other persons subject to the policy understand and appreciate its importance.

- Make clear that it is everyone's responsibility to comply with the policy. Each person should understand that a single noncompliant communication could result in potentially severe consequences, such as suspension or delay of the IPO.

- Educate front-line managers and supervisors to monitor compliance with the social media communications policy.

- Develop a process to control the type of information (e.g., only factual business information) and how corporate information will be disseminated by social media platforms.

- Instruct company directors that their own personal or professional use of social media must follow company policy.

Finally, companies should consider having internal and / or outside counsel review all information before it is posted on its website or social media outlets. In several SEC actions relating to Regulation FD and the Foreign Corrupt Practices Act (FCPA), the SEC chose not to bring an action against the company (and instead brought actions against the alleged infringing individuals only) where the SEC found the company had instituted a "culture of compliance," which included a written policy, controls and training. While instituting a "culture of compliance" may not prevent an SEC action with respect to an IPO gun-jumping violation, it may influence how the SEC views the violation and mitigate the penalty of noncompliance.

Intent is not required for the SEC to determine that gun-jumping has occurred and, given the number of followers an issuer may have on social media platforms, it may not be difficult for the SEC to find a violation. Thus, the best advice is for issuers to operate within SEC guidelines throughout any process that ultimately may culminate in an IPO.

Endnotes

1. Herb Greenberg, *Did Netflix Violate the Fair Disclosure Rule?*, CNBC (July 5, 2012), http: / / www.cnbc.com / id / 48086440 ("Congrats to Ted Sarandos, and his amazing content licensing team. Netflix monthly viewing exceeded 1 billion hours for the first time ever in June. When House of Cards and Arrested Development debut, we'll blow these records away. Keep going, Ted, we need even more!").
2. Attached to the same Current Report on Form 8-K disclosing the Wells notice was a response from Mr. Hastings arguing that the information, in addition to having been already public, was not material.
3. See *Corporate Finance Alert: Securities Offerings and Gun Jumping: What You Can and Cannot Do*, Skadden (Nov. 2012), *available at* http: / / www.skadden.com / sites / default / files / publications / Corporate_Finance_Alert_Securities_Offerings_and_Gun_Jumping_What_You_Can_and_Cannot_Do.pdf, for a comprehensive description of safe harbors and exceptions to the SEC's gun-jumping restrictions and practical guidance on what issuers can and cannot do with respect to communication activities generally.
4. See *Corporate Finance Alert: 'Jumpstart Our Business Startups Act' Signed Into Law*, Skadden (Apr. 2012), *available at* http: / / www.skadden.com / sites / default / files / publications / Corporate_Finance_Alert__Jumpstart_Our_Business_Startups_Act.pdf, for a summary of the JOBS Act and a description of the JOBS Act's "testing-the-waters" provisions.

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California Does It Again! Recommends Best Practices for the Mobile App Industry

By Leonard A. Ferber

In last month's *Technology Advisory*, I described recent actions of the California Attorney General designed to improve privacy protections for users of mobile applications. This included an agreement the California Attorney General ("CAG") reached with the companies whose platforms comprise the majority of the mobile app market (Amazon, Apple, Facebook, Google, Hewlett-Packard, Microsoft and Research In Motion) on a set of principles intended to ensure that mobile apps comply with applicable privacy laws such as the California Online Privacy Protection Act ("CalOPPA"), formation of the California Attorney General's Privacy Enforcement and Protection Unit (the "CAG's Privacy Unit") and enforcement against mobile app makers of CalOPPA's requirement that "online services" have privacy policies accessible to users.

California's Recommendations for the Industry

As part of this ongoing administrative effort, the CAG's Privacy Unit has now prepared *Privacy on the Go: Recommendations for the Mobile Ecosystem*, which stands as a formulation of "best practices" for the industry. As its name suggests, it encompasses recommendations for the entire "ecosystem"—from the app platforms and app developers to mobile ad networks, operating system developers and even mobile carriers.

The CAG's Privacy Unit sees its mission as supporting the right of privacy included in the California Constitution.[1] However, it also attempts to buttress its efforts with a "pro-business" rationale, pointing to a recent study finding that more than half of mobile app users had uninstalled or decided not to install an app because of concerns about its privacy practices.[2]

Seen in the larger picture, the CAG's Privacy Unit is seeking to influence the multi-stakeholder process being promoted by the Obama Administration, and currently being facilitated by the National Telecommunications and Information Administration ("NTIA"),[3] to develop an enforceable code of conduct for the mobile app industry. Accordingly, it is not surprising that, by its own admission, the CAG's Privacy Unit acknowledges that the *Privacy on the Go* recommendations "in many places offer greater protection than afforded by existing law."

The General Principles

In developing the recommendations, the CAG's Privacy Unit was guided by two principles. The first was the need for all members of the mobile app ecosystem to consider privacy implications early in the design and development process. This echoes recent Federal Trade Commission statements encouraging mobile app developers to adopt a "privacy by design" approach.[4] The second principle is "surprise minimalization." The CAG's Privacy Unit recognized that, although mobile devices are subject to the same privacy risks as traditional personal computers, there are some risks that are unique to mobile devices. For example, telephone call logs, text messages and location history are not typically found on personal computers, but are frequently stored by mobile devices. It also pointed out that mobile devices and apps can facilitate combinations of user and device-related data that may pose new privacy risks. The CAG's Privacy Unit further acknowledged that mobile devices' small screens make the effective communication of privacy practices and user choices difficult.

Privacy on the Go recommends that app developers "minimize surprises to users from unexpected privacy practices." The CAG's Privacy Unit suggests the most basic way to do this is to "avoid collecting personally identifiable data from users that are not needed for an app's basic functionality." Moreover, it recommends that developers "supplement the legally required general privacy policy with enhanced measures to alert users and give them control over data practices that are not related to an app's basic functionality or that involve sensitive information." California is taking the stand that it is no longer acceptable to bury disclosures and then hide behind a claim of "but it's in the privacy policy!"

Best Practices for App Developers

Although *Privacy on the Go* provides best practices for app platform providers, mobile ad networks, operating system developers and mobile carriers, the bulk of the recommendations are for mobile app developers, and I will be discussing only those recommendations in this article.

The specific recommendations which implement the "privacy by design" and "surprise minimalization" principles can be divided into two types: those that focus on a developer's approach to collecting and retaining data and those that focus on communicating the privacy and data policies and practices to users.

Collecting and Retaining Data. *Privacy on the Go* recommends that developers start by compiling a data checklist which lists the personally identifiable data the app could collect. Next, it is recommended that developers ask themselves specific questions about that data. For example:

- Is the data type necessary for your app's basic functionality (i.e., within the reasonably expected context of the app's functionality as described to users)?
- Is the data type necessary for business reasons (such as billing)?
- How will you use the data?
- How long will you need to store the data on your servers?
- Will you share the data with third parties such as ad networks, analytics companies or services providers?
- Is the app directed to or likely to be used by children under the age of 13?
- What parts of the mobile device do you have permission to access?

With this information, developers can create their privacy policies. In doing so, developers are instructed to reflect a desire to limit both data collection and data retention.

With respect to limiting data collection, *Privacy on the Go* suggests developers:

- Avoid or minimize the collection of personally identifiable data for uses not related to your app's basic functionality, and limit the retention of such data to the period necessary to support the intended function or to meet legal requirements.
- Avoid or limit the collection of sensitive information.
- Use an app-specific or other non-persistent device identifier rather than a persistent, globally unique identifier.
- Give users control over the collection of any personally identifiable data used for purposes other than the app's basic functions.
- Set default settings to be privacy-protective.

As for limiting data retention, *Privacy on the Go* suggests developers:

- Not retain data that can be used to identify a user or device beyond the time period necessary to complete the function for which the data was collected or beyond what was disclosed to the user.
- Adopt procedures for deleting personally identifiable user data that you no longer need.

Communicating Data and Privacy Policies. A written privacy policy is a requirement under CalOPPA. *Privacy on the Go* provides several admonitions focusing on how to communicate privacy policies to users, most of which should not be a surprise to anyone generally familiar with privacy policies:

Be Transparent

- Make privacy practices available to users before the app is downloaded and any data is collected.
- The general privacy policy is readily accessible from within the app.

Give Users Access

- Develop mechanisms to give users access to the personally identifiable data that the app collects and retains about them.

Make It Easy to Find

- Make the privacy policy conspicuously accessible to users and potential users.
- Post or link the policy on the app platform page to make it available to users before the app is downloaded.
- Link to the policy within the app (for example, on the controls / settings page).

Make It Easy to Read

Make the privacy policy clear and understandable by using plain language and a format that is readable on a mobile device. In this regard, two possible formats are suggested:

- A layered notice that highlights the most relevant privacy issues.
- A grid or "nutrition label for privacy" that displays privacy practices by data type.

Use "Enhanced Measures" as Appropriate

What is somewhat new, however, is that *Privacy on the Go* suggests that under certain circumstances, developers should supplement their general privacy policies with enhanced measures intended to alert users to these circumstances. *Privacy on the Go* offers several examples of the types of information the CAG's Privacy Unit believes would necessitate such enhanced measures:

- Collection, use or disclosure of personally identifiable data not required for the app's basic functionality.
- Accessing text messages, call logs, contacts or potentially privacy-sensitive device features such as a camera, dialer or microphone.
- A change in your data practices that involves new, unexpected uses or disclosures of personally identifiable data.

- The collection or use of sensitive information (such as precise geo-location, financial or medical information, or passwords).
- The disclosure to third parties of personally identifiable information for their own use, including use for advertising.

To the CAG's Privacy Unit, "clearer, shorter notices" of these privacy practices are necessary in the small-screen mobile environment. These should be "delivered in context and just-in-time" (i.e., just before the specific data is to be collected). Alternatively, use of the combination of a short privacy statement and privacy controls would be acceptable to the CAG's Privacy Unit. According to *Privacy on the Go*, "the short privacy statement should highlight the potentially unexpected practices and sensitive information" and "readily accessible privacy controls should give users a convenient way to make choices and to change them when desired."

What You Should Know

What happens in California exerts a tremendous influence on the rest of the country when it comes to issues of privacy (in more common parlance, "what happens in California doesn't stay in California"). Besides putting its own "marker" on the quest to establish industry-accepted "best practices," *Privacy on the Go*'s focus on surprise minimalization and practical steps designed to accomplish this are likely to find wide acceptance among the regulators at the Federal Trade Commission and in the industry-wide initiatives promoted by the NTIA. In particular, the use of enhanced measures—special notices or the combination of a short privacy statement and privacy controls—intended to draw users' attention to the gathering of sensitive information or the use of data practices that may be unexpected and to enable them to make meaningful choices is likely to become the norm. This would require a refinement of the old privacy policy adage of "say what you do / do what you say" to include "and say it in a manner so that it will have a good chance of being noticed."

A company that simply provides an app as part of a mobile strategy directly related to its core business will find California's recommendations to be instructive and adoption to be relatively painless. A business seeking to leverage the data collection aspects of apps in order to become a "data company" will find the recommendations proposing limiting data collection and data retention more troublesome. However, a careful reading of all the recommendations suggests that surprise minimalization is truly the paramount concern. Increased sensitivity to providing disclosures of a company's collection of sensitive information or unsuspected data use in a manner reasonably likely to be seen by users is, at the end of the day, what will be required of "data companies."

Endnotes

1. Cal. Const. art. I, § 1 ("All people are by nature free and independent and have inalienable rights. Among these are enjoying and defending life and liberty, acquiring, possessing, and protecting property, and pursuing and obtaining safety, happiness, and privacy.").
2. Jan Lauren Boyles, Aaron Smith & Mary Madden, *Privacy and Data Management on Mobile Devices*, Pew Internet & Am. Life Project (Sept. 5, 2012), http://pewinternet.org/Reports/2012/Mobile-Privacy.aspx.
3. *See* The White House, Consumer Data Privacy in a Networked World: A Framework for Protecting Privacy and Promoting Innovation in the Global Digital Economy (Feb. 2012).
4. *See, e.g.*, Federal Trade Commission, Protecting Consumer Privacy in an Era of Rapid Change: Recommendations For Businesses and Policymakers (Mar. 2012).

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Significant Issues Arising Under Confidentiality Agreements (a/k/a Non-Disclosure Agreements)

By Melvin Katz and Stuart B. Newman

Attorneys who specialize in corporate transactions know that the first document drafted in any such transaction is usually a Confidentiality Agreement, sometimes also called a Non-Disclosure Agreement, or "NDA." Two recent cases decided by the Delaware courts have a direct bearing on both the express provisions of Confidentiality Agreements and the obligations imposed on recipients of non-public information pursuant to the Confidentiality Agreement as part of their due diligence process. These cases underscore the fact that a well-crafted NDA may prove to be critical for your client and that it should be drafted and negotiated with the same care and attention a good lawyer gives to the entire transaction.

While this article focuses on Confidentiality Agreements in the context of M&A transactions—transactions contemplating the sale or merger of companies or their businesses—the importance of these agreements in other business settings is not to be overlooked. Confidentiality Agreements, in one or another form, play an important role in such transactions as joint ventures, prospective debt financings or equity investments and protections of trade secrets. The two recent cases and the Confidentiality Agreements at issue in these cases involved prospective sales of businesses. The Delaware courts' application of the law to the facts of each case provides practical lessons for practitioners in drafting such agreements for their clients.

In *RAA Management LLC v. Savage Sports Holdings, Inc.*,[1] the Delaware Supreme Court discussed the legal effect to be given to the "non-reliance" and "waiver" provisions typically included in Confidentiality Agreements. These "non-reliance" and "waiver" provisions are inserted in well-drawn Confidentiality Agreements for the purpose of protecting the provider of the confidential, non-public information (most often, the Seller) from liability for any inaccurate or even misleading representations and other factual disclosures made or furnished by the provider to the bidder until and unless the parties enter into definitive acquisition or merger agreements, by reason of which the provisions of the Confidentiality Agreement are superseded by more explicit representations and warranties negotiated by the parties.

After reviewing the confidential information supplied by the Seller, Savage Sports, pursuant to the Confidentiality Agreement, the prospective Buyer, RAA Management, ultimately determined *not* to purchase the Seller. RAA Management claimed that it independently discovered that Savage Sports had significant unrecorded claims and liabilities although Savage Sports executives had denied the existence of such claims or liabilities prior to the start of the due diligence review of materials furnished by it to RAA Management pursuant to the Confidentiality Agreement. By reason of these subsequent discoveries, RAA Management dropped its pursuit of Savage Sports and sued to recover $1,200,000 in due diligence costs and negotiating fees and expenses incurred in the aborted transaction. RAA Management claimed that had it been aware of these undisclosed claims and liabilities prior to the commencement of its due diligence efforts, they would not have sustained those fees or incurred those expenses.

RAA Management tried to advance the argument that these "non-reliance" and "waiver" clauses did not apply to "fraudulent inducement" by Savage Sports or to information within the "peculiar knowledge" of Savage Sports. The Delaware Supreme Court rejected these contentions, pointing out, among other considerations, that sophisticated parties may not reasonably rely on representations made "outside" of a contract where, as in this case, the NDA contained a provision explicitly disclaiming reliance upon such "outside" representations or information.

"Waiver" and "non-reliance" clauses are, or should be, inserted in Confidentiality Agreements to assure that the disclosing party should not be held liable for the accuracy or reliability of information furnished to the recipient unless the parties enter into definitive merger, acquisition or other transaction agreements. "Waiver" and "non-reliance" clauses in a Confidentiality Agreement are of particular importance in these situations where a transaction is not consummated, but where considerable written and oral information and data are given to the other party both "under" or "outside" the Confidentiality Agreement. These provisions should be kept in mind by practitioners when a client proposing to sell its business enters into Confidentiality Agreements with one or more prospective Buyers.

In this case, the Court made several pertinent statements in support of its rejection of RAA Management's claim, including the following:

(a) The breadth and scope of these "waiver" and "non-reliance" clauses were defined by the parties in their Confidentiality Agreement, indicating that the prospective Buyer, RAA Management, was bound by these clauses as written;

(b) The case involved two sophisticated parties who agreed that the bidder could not rely upon or bring suit by reason of the due diligence information "or any other information provided or prepared by or for the Company" (Savage Sports) if they failed to reach agreement for its sale; and

(c) Sophisticated parties may not reasonably rely upon representations (most often oral) made at the outset of negotiations where the Confidentiality Agreement, as in this case, contains a provision explicitly disclaiming reliance upon such "other information" beyond the four corners of the Agreement, nor can these parties ignore the "waiver" provisions in the Agreement.

The RAA Management case demonstrates the importance of non-reliance and waiver clauses in a Confidentiality Agreement. In addition, the actual language in well-drawn Confidentiality Agreements should, in our view, be drafted expressly to cover all representations and / or other disclosures or "other information" made or provided by the disclosing party "prior to" or "beyond" the scope of the Agreement as well as "during" the due diligence process and to cover "oral" as well as "written" misrepresentations and omissions to disclose material facts.

The second Delaware case, *Martin Marietta Materials v. Vulcan Materials Company*,[2] raises questions of importance for the Seller from the standpoint of the protections that well-drawn Confidentiality Agreements give the Seller in the event that the bidder or prospective Buyer attempts to use the confidential information obtained during the due diligence process for purposes that are in violation of the contractual protections afforded by the Confidentiality Agreement—e.g., if prospective bidders attempt to use the information for hostile bids to acquire the Seller, for anti-competitive purposes or for misuse of trade secrets obtained during the due diligence process.

In *Martin Marietta*, Vulcan Materials and Martin Marietta entered into two Confidential Agreements pursuant to which Vulcan Materials, the prospective Seller, furnished a substantial amount of non-public information concerning Vulcan to Martin Marietta.[3] While the Confidentiality Agreements between the parties lacked a "standstill" provision, the language respecting the purpose of the exchange of the "Evaluation Material" clearly contemplated solely a consensual transaction between the parties. As the negotiations wore on, the respective stock market prices of Vulcan and Martin Marietta moved in the wrong direction from the standpoint of Vulcan. Its management, therefore, lost enthusiasm for the transaction. Martin Marietta, on the other hand, was even more anxious to acquire Vulcan, and it commenced a hostile bid for Vulcan, including an exchange offer and a proxy fight to obtain control of the Vulcan board.

In the course of Martin Marietta's hostile bid, it used certain confidential information obtained from Vulcan pursuant to the above-noted Confidentiality Agreements, and disclosed such information in SEC filings and in other proxy soliciting materials. Martin Marietta used certain of this confidential information to cast Vulcan's management in a poor light, to make its own offer appear attractive to Vulcan stockholders and to pressure the Vulcan Board to accept the offer of Martin Marietta.

The Delaware Chancery Court found that Martin Marietta blatantly violated its Confidentiality Agreement with Vulcan Materials and preliminarily enjoined Martin Marietta from undertaking any further attempts to acquire Vulcan for a four-month period. One of the defenses of Martin Marietta was that it was required to disclose this confidential information in its SEC filings and, therefore, these disclosures came within the customary exceptions in Confidentiality Agreements with respect to required filings with the government or in response to subpoenas, etc. The court did not accept this argument, holding that neither the language nor the intent of the specific Confidentiality Agreement encompassed voluntary filings by one of the parties with the SEC in furtherance of its hostile bid without prior notice to, and opportunity to object by, the other party to the Agreement.

The *Martin Marietta* case illustrates the importance of NDA protections for the prospective Seller in M&A transactions. In addition, there are some practical lessons and drafting suggestions that can be derived from the *Martin Marietta* case.

First, from the standpoint of the Seller, the importance of drafting specific performance and injunctive relief clauses should never be overlooked. They are of considerable importance and, in that connection, the Seller (or other provider of information) should insist that the NDA expressly stipulate the existence of "irreparable harm" in the event that the prospective Buyer (i.e., the recipient of the information) violates the terms of the Agreement. Indeed, the Delaware Supreme Court confirmed that express contractual stipulations with respect to irreparable harm "'*alone* suffice to establish that element for the purpose of issuing…injunctive relief.'"[4]

Second, it would be advisable for the NDA to contain broad express "standstill" provisions. Clearly, if the Seller is a publicly held entity, broad "standstill" provisions prohibiting the Buyer from launching a hostile tender offer or proxy contest, or otherwise attempting to appropriate the business or using the non-public confidential information for competitive purposes, or to misappropriate trade secrets should be included in the Confidentiality Agreement.

Broad "standstill" provisions or their functionally equivalent provisions in Confidentiality Agreements serve an important purpose in the private, as well as the public, company context. For example, it might be difficult to prove that a bidder in an aborted transaction may be using confidential information obtained under a Confidentiality Agreement for competitive purposes. However, it seems that a prohibition against such use in a "standstill" provision in a Confidentiality Agreement might (or in another document executed by the bidder and the issuer) well serve as a deterrent; and, if litigation is required to enjoin such use of the confidential information for competitive purposes, the existence of that clause in a broadly drawn standstill provision will be duly noted and taken into account by the courts.

Third, from the standpoint of a bidder or prospective Buyer, the NDA should expressly provide that the parties may disclose information, as reasonably required in the opinion of its counsel, in SEC or other government agency filings or to comply with Stock Exchange requirements. From the standpoint of the Seller, however, the "notice" and objection procedures in favor, typically, of the Seller should provide that if that Buyer or the other party seeks to disclose all or portions of the confidential information, it should be required to give the Seller notice of such pending disclosure, and the Seller should have a reasonable opportunity to contest, limit or restrict the disclosure or dissemination of that information; and such disclosure restrictions should expressly apply to all public disclosures of the confidential transaction information regardless of whether such disclosure is to be made in response to a subpoena or in connection with SEC or other agency filings or Stock Exchange requirements.

Fourth, the NDA should explicitly state that the confidential information furnished pursuant to the Agreement is in contemplation of a "consensual" or "voluntary" transaction (or agreement) between the parties, that the "permitted use" of such confidential information is limited solely to a consensual transaction approved in advance by the boards of both companies, and that such information should, therefore, not be used for any other purpose, including hostile bids or for anti-competition purposes.[5] Both the Delaware Chancery and Supreme Courts stressed the significance of that language (in different formulations) in the two Confidentiality Agreements that Vulcan and Martin Marietta executed.[6]

There are other valuable lessons to be derived from the *Martin Marietta* decision; most of them, however, apply to bidders who change their approach and decide to go "hostile" after negotiating with the prospective Seller. For example, if you were representing such a client, it would be sound advice to destroy the confidential information acquired under the Confidentiality Agreement once circumstances change and to use a new "clean" professional team to advise the prospective bidder before launching the hostile attack.

Although not covered in this article, in drafting and negotiating NDAs, the practitioner should also focus upon broad definitions of the confidential information furnished pursuant to its terms, and the responsibility of the recipient for the actions of its representatives with respect to the confidentiality of this information. The practitioner should also expressly specify the duration of the confidentiality period.

Above all, remember that in the complex, high stakes universe of the corporate lawyer, when it comes to Confidentiality Agreements, as with all other important agreements, one size does *not* fit all, and a practitioner is well advised to devote adequate time and attention to their terms and provisions.

Endnotes

1. RAA Mgmt., LLC v. Savage Sports Holdings, Inc., 45 A.3d 107 (Del. 2012).
2. Martin Marietta Materials, Inc. v. Vulcan Materials Co., 56 A.3d 1072 (Del. Ch. 2012). This case was first decided by the Delaware Chancery Court in May 2012. The decision was affirmed by the Delaware Supreme Court in July 2012. Martin Marietta Materials, Inc. v. Vulcan Materials Co., 2012 WL 2783101 (Del. July 10, 2012).
3. Confidential information and data are often referred to as "Evaluation Information" in Confidential Agreements.
4. *Martin Marietta Materials, Inc.*, 2012 WL 2783101, at *14 (Del. July 10, 2012) (emphasis added) (quoting Cirrus Holding Co. Ltd. v. Cirrus Indus., Inc., 794 A.2d 1191, 1209 (Del. Ch. 2001)).
5. Typically, however, many Confidentiality Agreements require that if a consensual transaction between the parties does not close within a specified time period, the Buyer or other recipient of the Confidential Information should be required to destroy all such information and data and return all copies thereof to the Seller or the other provider of the Information.
6. Two different Confidentiality Agreements were executed by Martin Marietta and Vulcan. The first was a standard "NDA" which provided that Martin Marietta was obligated to "use Evaluation Materials solely for the purpose of evaluating a Transaction" and "Transaction" was defined as a "possible business combination transaction" between the parties or one of their respective subsidiaries. The second, the Joint Defense Agreement (for anti-trust purposes), defined "transaction" as a "potential transaction being discussed by Vulcan and Martin Marietta" involving a combination of all or certain of their assets or stock. The Delaware Chancery Court concluded that the hostile exchange offer and / or a proxy contest were clearly inconsistent with the consensual contemplated "business combination" language in these two agreements between the parties.

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Solving the "Anywhere but Chancery" Problem: Why the Intra-Corporate Forum Selection Clause Is Currently Inadequate

By Benjamin P. Chapple

> *Perhaps greater judicial oversight of frequent filers will accelerate their efforts to populate their portfolios by filing in other jurisdictions.… If boards and directors and stockholders believe that a particular forum would promote an efficient and value promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.*
>
> **—Vice Chancellor Laster**

I. Introduction

On May 16, 2010, in *In re Revlon, Inc. Shareholders Litigation*,[1] Vice Chancellor Laster penned the above sentence in response to members of the plaintiffs' bar who are *frequently* filing shareholder suits outside of Delaware, because they feel their cases have more settlement power "[a]nywhere [b]ut Chancery."[2] Although multiple factors motivate plaintiffs to file outside of Delaware,[3] most reasons are premised on increasing the settlement value of their cases by making litigation less predictable, and as a result riskier for the corporate-defendant.[4] Further, these litigants only flee Delaware when they believe the case is more valuable in a non-Delaware forum. As will be explained, this is not always the case.[5]

The "anywhere but Chancery" phenomenon has attracted considerable academic discussion,[6] with scholars proposing different solutions to keep corporate law disputes within Delaware.[7] Some argue that the problem can be solved if corporations adopt an intra-corporate forum selection clause.[8] A forum selection clause, in the corporate law context, is a provision within a corporation's charter or bylaws that designates an exclusive forum—often the Delaware Court of Chancery[9]—to adjudicate any intra-corporate dispute[10] that arises between the shareholders and board of directors.[11] Because the Court of Chancery is so consistent, if it is selected as the exclusive forum, directors and officers can exercise better business judgment as they "may usually order their affairs to avoid lawsuits."[12]

Whether due to this academic advice,[13] or perhaps as a result of passing statements from Delaware's corporate bench indicating it would enforce such a clause,[14] corporations have responded to the "anywhere but Chancery" phenomenon by adopting provisions, almost invariably selecting the Delaware Court of Chancery.[15] In fact, as of June 30, 2011, 133 publicly traded entities had forum selection provisions in their charter or bylaws, with 58.6 percent appearing in the former and 41.4 percent appearing in the latter.[16] Of these, 88 percent[17] were adopted after Vice Chancellor Laster's observation in *Revlon*.[18]

While Delaware judges appear to favor these exclusive forum provisions,[19] at least some non-Delaware judges do not.[20] This is problematic, because currently a countless number of courts have the authority to choose whether or not to enforce a corporation's clause when a shareholder challenges it as unenforceable.[21] As a result, the purpose for adopting a clause—promoting predictability[22]—is *significantly* undermined, because some courts will enforce it, while others will not,[23] leaving directors and officers to speculate whether they'll be forced to litigate in a non-Delaware forum—notwithstanding the presence of a provision stating that venue is improper.[24] Furthermore, because the Delaware Court of Chancery is invariably selected as the exclusive forum, it is non-Delaware judges who will most often decide whether or not to enforce a corporation's clause. The fact that Delaware judges appear to favor these provisions, therefore, is of little moment since typically they will not be the parties opining.

> *"Although multiple factors motivate plaintiffs to file outside of Delaware, most reasons are premised on increasing the settlement value of their cases by making litigation less predictable, and as a result riskier for the corporate-defendant."*

This article agrees that adopting an intra-corporate forum selection clause is a promising solution, but argues these provisions do not currently ensure that litigation will remain in Delaware because there is not uniform enforcement.[25] Inconsistent enforcement financially taxes the corporate-defendant (and indirectly its shareholders) because it is forced to litigate in multiple jurisdictions as well as fight to have its forum selection clause enforced.[26] This article argues that the only way to *guarantee* these provisions are nationally enforced is through congressional mandate.[27] Because of this conclusion, the article next discusses how previous Acts of Congress—the two most recent being (1) the Sarbanes-Oxley Act of 2002 (hereinafter "Sarbanes-Oxley"), and (2) the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2012 (hereinafter "Dodd-Frank")—have been met with significant opposition, particularly by proponents of Delaware-governed corporate law.[28] This article explains how these previous Acts, which many view as intrusive and misplaced, have led to a serious concern that Congress is slowly occupying corporate governance—a role historically left to the states—and will ultimately usurp Delaware's control of corporate law completely.[29] Professor Bainbridge coined this "the creeping federalization of corporate law."[30]

Therefore, a catch-22 arises.[31] On the one hand, it would be beneficial if Congress intervened and mandated uniform enforcement, as corporations could rest assured that their clause would be respected, and also because more shareholder litigation would remain in Delaware. On the other hand, if Congress did intervene, it would further federalize corporate law, something that many proponents of Delaware corporate law adamantly oppose.

Regardless of the merits (or flaws) of federal intervention, the enforceability of intra-corporate forum selection clauses will continue to be hotly contested, at least until case law develops and principles (such as comity) prevail. The fact is, without uniform enforcement these provisions may prove useless in preventing the "frequent filer" plaintiffs who "populate their portfolios by filing in [non-Delaware] forums,"[32] and will at a minimum increase the cost of litigation.[33] Accordingly, this article urges directors and officers to avoid relying on intra-corporate forum selection clauses until more certainty exists.[34]

II. The Intersection of Delaware's Dominance and the "Anywhere but Chancery" Phenomenon

A. Delaware's Dominance

Although corporate governance has for the most part been left to the *states*,[35] if you know only one thing about corporate law, it is probably that Delaware commands the market for incorporations.[36] With approximately 60 percent of all publicly traded companies incorporated there,[37] Delaware generates over 25 percent of its revenue from taxes and fees assessed to these corporations, totaling over five-hundred million dollars; that's not accounting for the typical two-hundred million dollars that the state reaps annually through unclaimed escheated dividends.[38] Accordingly, Delaware benefits greatly from its position as the preferred state of incorporation and would suffer immensely if that status were lost.

i. Academic Debate: Race to Bottom v. Race to Top

Scholars have debated whether Delaware's control over corporate governance is a good thing.[39] In his now famous article titled *Federalism and Corporate Law: Reflections Upon Delaware*,[40] Professor William Cary—reasoning that directors and officers are the parties who choose to make their corporation become a Delaware-chartered corporation, or have it remain so—argued that Delaware's system of corporate governance created a "race to the bottom" where the state's bench and legislature, in an effort to remain the preferred state of incorporation, cater to managers by offering a lax legal system that provides little managerial accountability and oversight.[41] Proponents of the race to the bottom theory commonly support the federalization of corporate law, viewing Delaware's approach as failed.[42]

On the other hand, Ralph Winter,[43] among others,[44] criticized Cary's race to the bottom theory and instead posited that Delaware's system creates a "race to the top."[45] The race to the top theory argues that if a state caters too excessively to management—as Cary's race to the bottom theory posits—investors will not purchase, or will at least pay less for, the corporation's securities because "lenders will not make loans to such [corporations] without compensation for the risks posed by management's lack of accountability.[46] As a result, those [corporations'] cost of capital will rise, while their earnings will fall."[47] In turn, these corporations "become more vulnerable to a hostile takeover and subsequent management purges."[48] Winter and others argue, therefore, that a race to the top is created, because directors and officers have strong incentives to incorporate in a state offering rules preferred by investors and lenders.[49]

ii. Delaware's Corporate Bench

Even considering the various academic theories that attempt to explain Delaware's dominance, it is difficult to dispute that corporations choose to incorporate in Delaware, at least in part, because the state's judiciary is one of the most, if not the most, experienced and adept at adjudicating corporate law disputes.[50] Delaware's corporate judiciary consists of ten judges, with five Justices who sit on the state's Supreme Court,[51] and four Vice Chancellors as well as one Chancellor who sit on the Court of Chancery—the court of equity in which shareholders bring suit.[52] Because Delaware does not have an intermediate appellate court, all Chancery litigants have an absolute right to appeal; however, the court's decisions are so well respected that the majority of their judgments are not challenged.[53] Of course, some cases are appealed, and, unlike the highest courts of other states, the Justices of the Delaware Supreme Court almost always write unanimously.[54] Moreover, since 1899 Delaware courts have adjudicated thousands of corporate law cases, interpreting virtually every provision of Delaware's corporate law statutes.[55] In turn, the process of decision-making has been so refined that directors and officers can often avoid lawsuits because the consistency of the courts' decisions enables them to better predict how Delaware's bench would rule if a particular business decision were challenged.[56]

iii. Internal Affairs Doctrine

In order to properly appreciate the intersection of Delaware's dominance and the "anywhere but Chancery" phenomenon, it is essential to fully understand the implications of the internal affairs doctrine. The United States Supreme Court has made clear that "[t]he authority of a state to regulate the internal affairs of the corporations it charters is one of the oldest and most firmly established doctrines in American Corporation law."[57] The internal affairs doctrine requires the state of incorporation's law to govern any dispute pertaining to the corporation's internal affairs, regardless of the quantity or quality of contact the corporation has with its state of incorporation.[58] As Justice Randy J. Holland of the Delaware Supreme Court explained:

> The internal affairs doctrine protects corporations from being subjected to inconsistent legal standards. It is premised on an *important public policy that the authority to regulate a corporation's internal affairs should not rest with multiple jurisdictions.* The United States Supreme Court has held that…[p]ursuant to the Due Process Clause in the Fourteenth Amendment of the United States Constitution, directors and officers of corporations have a significant right…to know what law will be applied to their actions and [s]tockholders…have a right to know by what standards of accountability they may hold those managing the corporation[]….'"[59]

Therefore, if a shareholder of a Delaware-chartered corporation files suit in a non-Delaware forum, the internal affairs doctrine generally ensures[60] that Delaware law will govern the dispute.[61] The internal affairs doctrine does not, however, ensure that Delaware law will be applied correctly[62]—a possibility that some members of the plaintiffs' bar seek to exploit.[63]

B. "Anywhere but Chancery" Phenomenon

Many members of the plaintiffs' bar believe that they can increase the size and frequency of settlements from corporate-defendants by filing shareholder litigation "anywhere but Chancery."[64] When the claim is weak, or perhaps even meritless, plaintiffs will file in a non-Delaware forum where the court is less likely to properly apply the law, thereby trying to leverage this potential misapplication against the defendant-corporation, hoping it will seek to settle to avoid an uncertain, risky outcome.[65] When the plaintiffs have a strong claim, however, they will not flee, but instead will file in Delaware, where the Court of Chancery will properly provide relief.[66]

The purpose of this article, unlike others, is not to delve into the various catalysts of the "anywhere but Chancery" phenomenon.[67] Rather, it is enough to understand that although the internal affairs doctrine mitigates the uncertainty of defending an action filed outside of Delaware, there is still the significant risk that the non-Delaware court will misapply Delaware law and reach a holding inconsistent with its proper interpretation.[68] Indeed, it appears that members of Delaware's corporate bench hold this view.[69] As Vice Chancellor Strine explained: "[t]he important coherence-generating benefits created by our judiciary's handling of corporate disputes are endangered if *our state's compelling public policy interest* in deciding these disputes is not recognized and decisions are instead *routinely* made by a *variety* of state and federal judges who only deal *episodically* with our law."[70] This view is also shared by Ted Mirvis, a well-respected corporate law practitioner, who states: "[t]rying to argue Delaware fiduciary cases outside of Delaware is like taking Gallatoire's secret recipes and giving them to a Jack-In-The-Box short-order cook. It doesn't always work so well."[71]

Accordingly, having non-Delaware judges routinely deciding shareholder suits poses a substantial risk that the law will be misapplied and frustrate the predictability Delaware corporate law *should* provide.[72] If this problem is not addressed, not only will corporations be robbed of the benefits provided by Delaware courts, but also the state's judiciary will lose the opportunity to decide "good" cases that are needed to develop important new precedents.[73] Timely research conducted by Armour et al. indicates that Delaware's judiciary recently missed the opportunity to meaningfully develop what responsibilities directors have to oversee option granting practices because "the vast majority of…suits involving Delaware companies" were decided by non-Delaware judges.[74]

III. The Intra-Corporate Forum Selection Clause

Some argue that the intra-corporate forum selection clause is the best solution to the "anywhere but Chancery" phenomenon.[75] As stated *supra*, a forum selection clause, if enforced, would allow corporations to designate the Delaware Court of Chancery as the exclusive forum to adjudicate lawsuits that arise between the corporation and its shareholders.[76] This, theoretically, is a perfect solution.

A. Benefits of Adoption

By adopting a forum selection clause, directors and officers can make more informed business decisions, because they are not forced to prognosticate which court will adjudicate a lawsuit *when* their decisions result in shareholder challenge.[77] Additionally, part of the premium that a corporation, and in turn its shareholders, pay to be a Delaware-chartered corporation results from the state's experienced corporate law judiciary.[78] Unlike the Delaware Court of Chancery—which has an international reputation for adjudicating corporate law disputes—other jurisdictions do not specialize in corporate law matters, but rather have general dockets with issues ranging from property cases to slip and fall claims.[79] As Vice Chancellor Laster stated during a hearing in *In re Compellent Technologies*, "[i]t is not that we're smarter, it's not that we're better judges. It is just that we do it a lot and see it a lot. It's the basic idea of comparative advantage. When you do something over and over again, you develop expertise."[80] A forum selection clause, therefore, provides a mechanism to ensure that corporations receive a Delaware benefit for which they are paying—the erudite corporate law decisions handed down by the state's corporate judiciary.

Adopting an intra-corporate forum selection clause also enhances the principles of the internal affairs doctrine. As Justice White explained, "[t]he internal affairs doctrine…recognizes that only one state *should* have the authority to regulate…the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands."[81] Although Delaware's law should govern regardless of where the shareholder files suit, this is meaningless if the law is not applied faithfully, because corporations may still face conflicting demands.[82] Justice Holland explained that "directors and officers of corporations 'have a *significant right*…to know what law will be applied to their actions' and '[s]tockholders…have a right to know by what standards of accountability they may hold those managing the corporation[]….'"[83] Selecting the Delaware Court of Chancery as its exclusive forum allows corporations and shareholders to have the "significant right" of knowing not only what law will apply to their disputes, but also the right to know that the law will be applied faithfully.

B. Uncertainty Remains

Although this article agrees that adopting an intra-corporate forum selection clause is the best way to curtail the "anywhere but Chancery" phenomenon, a problem still remains. Plaintiffs will first challenge the enforceability of these provisions in the non-Delaware forum before proceeding to the underlying merits of their suit.[84] As a result, the enforceability of a corporation's forum selection clause will be determined by a myriad of non-Delaware federal and state courts.[85] Allowing so many courts to determine the validity of a forum selection clause creates the potential that the provision will be interpreted inconsistently, undermining its intended purpose of facilitating predictability for better business planning.[86] Unsurprisingly, a split in authority is developing as some recent court decisions have refused to enforce these provisions, while other decisions have stated that they would respect and enforce them.[87] In addition to impeding predictability, having a split in authority also increases litigation costs because adversaries will have one more thing over which to litigate.[88] Once a court makes it clear that it will enforce a corporation's forum selection clause, plaintiffs will simply file in a different non-Delaware forum where they can argue the provision should be unenforceable. Until all fifty states have addressed enforceability—which will take considerable time—uncertainty will remain.[89] Accordingly, intra-corporate forum selection clauses *would* solve the "anywhere but Chancery" problem, but *only if* they are enforced nationally.

C. Enforceability Challenges

Forum selection clauses have been used in other contexts for many years,[90] although the intra-corporate type is relatively novel. As a result, there is a dearth of cases concerning the enforceability of these provisions. The first reported case addressing the enforceability of a corporation's forum selection clause is the 2011 decision *Galaviz v. Berg*.[91] In *Galaviz*, the United States District Court for the Northern District of California refused to enforce a forum selection clause adopted by the Delaware corporation Oracle.[92] Understanding the particular facts of *Galaviz* indicates that the court's holding might have changed under different factual circumstances.[93] The *Galaviz* plaintiffs alleged that between 1998 and 2006, Oracle conducted a variety of fraudulent and improper practices, thereby overcharging the United States government millions of dollars.[94] In 2006, Oracle's board of directors adopted a forum selection clause by unilaterally passing a resolution amending its bylaws.[95] Because "the venue provision was unilaterally adopted by the directors…after the majority of the purported wrongdoing [had already] occurred, and without the consent of existing shareholders who acquired their shares when no such bylaw was in effect[,]" the district court found it violated fundamental principles of contract law, and was therefore unenforceable.[96] The court went on to state, however, that the arguments for enforcing the forum selection clause would have been much stronger if a majority of shareholders approved a charter amendment, even where a particular shareholder-plaintiff personally voted against the amendment.[97]

Aside from the challenge in *Galaviz*, twelve class action complaints were recently filed in the Delaware Court of Chancery challenging forum selection clauses that were adopted as bylaw provisions without prior shareholder approval.[98] Four additional suits have been filed in Chancery by shareholders challenging proposed exclusive forum charter or bylaw amendments that were adopted by the board but not yet submitted to a shareholder vote.[99] A suit was also filed in the U.S. District Court for the Northern District of California, challenging the forum selection bylaw provisions that were adopted without shareholder approval.[100] Regardless of the decisions in the cases currently under suit, "conflicting views may emerge from other courts who may, on public policy or other grounds, refuse to dismiss complaints brought in their home courts notwithstanding a forum selection provision indicating that venue is improper."[101]

IV. Guaranteeing Uniform Enforcement via Congressional Intervention: Is the Risk Worth the Reward?

The efficacy of intra-corporate forum selection clauses is dependent on uniform, national enforcement because selective enforcement undermines the purpose for which these provisions are adopted.[102] Currently, corporations pay the costs associated with adopting a clause thinking it will facilitate certainty, only to have it challenged, pay additional costs defending its enforceability, and ultimately have the non-Delaware court hold the provision invalid. These provisions are adopted to provide certainty—this is not certainty. Although some commentators believe that the United States Supreme Court will ultimately decide the enforceability of these provisions,[103] considering that the Court "is not at liberty to fashion any kind of federal common law of corporations, or otherwise to trump state law, unless Congress expressly so provides," it is unlikely to act.[104] Assuming *arguendo* that the Supreme Court did proscribe the enforceability of these provisions, it is undisputed that the Court's authority to regulate corporate law is inferior to Congress's.[105] Accordingly, only Congress can provide *definitive* enforcement on a national level. The question is, however, should Congress act?

A. Previous Congressional Involvement in Corporate Law

Although it has yet to do so,[106] given the Supreme Court's broad reading of the Commerce Clause, Congress would certainly be within its authority to pervasively regulate corporate law at any moment.[107] Over the past decade, Congress passed two Acts—Sarbanes-Oxley[108] and Dodd-Frank[109]—that have generated serious criticism, particularly by proponents of Delaware-governed corporate law.

i. Sarbanes-Oxley

Following the oversight failures that led to Enron, Worldcom, and HealthSouth, Congress promulgated Sarbanes-Oxley in 2002.[110] This Act (1) imposed certification requirements on corporate officials,[111] (2) mandated independent audit committees,[112] (3) required more stringent internal corporate controls,[113] and (4) barred loans to corporate officers.[114] Some refer to this Act as "quack corporate governance" because, they say, Congress had no idea what it was doing.[115] They cite, for example, section 404 of Sarbanes-Oxley, which imposed the requirement that the corporation's outside auditor and management must certify the effectiveness of the company's internal controls over financial reporting.[116] The SEC projected that it would cost companies on average $91,000 to comply with this section; however, a survey conducted three years after the Act went into effect reported the cost as "$7.3 million for large accelerated filers and $1.5 million for accelerated filers."[117]

ii. Dodd-Frank

Congress went even further with the recent adoption of Dodd-Frank in 2010.[118] Many argue that Dodd-Frank interferes with the allocation of decision-making authority within the corporation.[119] This "interference" is accomplished through two provisions. Both increase shareholder power: say-on-pay[120] and proxy access.[121] In short, say-on-pay mandates that corporations allow their shareholders to vote to express whether they are satisfied with executive compensation.[122] Although the vote is purely advisory, issuers are required to disclose the results and state whether the vote was considered "in determining compensation policies and decisions, and, if so, how that consideration has affected the registrant's executive compensation decisions and policies."[123] Some argue this interferes with the corporate form.

The second notable provision of Dodd-Frank (proxy access), although short lived, intruded into state control over corporate governance by "creat[ing] a federal right for shareholders to nominate corporate directors, subject to a complex set of conditions."[124] The proxy access provision of Dodd-Frank, Rule 14a-11[125] was so hotly contested that a lawsuit was promptly filed, causing the D.C. Circuit to invalidate the rule in *Business Roundtable v. SEC*.[126] Although invalidated, it is important to realize what the provision would have accomplished if it had remained valid.[127] Rule 14a-11 provided a mechanism for shareholders to exercise nominating power, by offering "a single, highly restrictive mechanism that could not be tailored to address issuer-specific needs."[128] This is troubling, as one scholar stated, because "[u]nlike the Delaware courts and legislature, which are experts in corporate governance…and the relationship between the election process and other structural components of shareholder voting power, the SEC lacks any institutional competence to assess the value of increased shareholder voting power or enhanced director accountability."[129]

B. Uniform Enforcement Through Congressional Action Presents a Catch-22

Although the utility of federalizing corporate law has been and will continue to be debated, it is undisputed that previous Acts of Congress, such as Sarbanes-Oxley and Dodd-Frank, have generated significant debate surrounding what has been coined "the creeping federalization of corporate law."[130] This has created many opponents of federal involvement, particularly the Delaware bench and bar, who fear that these previous congressional intrusions represent minor, but ever increasing, federal involvement in corporate law that will eventually lead to Delaware being stripped of its dominance.[131] Many proponents of Delaware-governed corporate law, therefore, abhor *any* suggestion that Congress become more involved because they fear the slippery slope that will eventually lead to the complete federalization of corporate law.[132]

Accordingly, achieving definitive, uniform enforcement of intra-corporate forum selection provisions creates a catch-22.[133] Many proponents of federal intervention—for example, the race to the bottom theorists—argue that Delaware's corporate governance system is broken.[134] However, if Congress mandated national enforcement, it would (1) keep more litigation inside of Delaware, as well as (2) serve as validation by Congress that Delaware's system is not failed. The irony is equally apparent when you consider how proponents of Delaware-governed corporate law are affected by this dilemma.[135] Specifically, Delaware would benefit greatly from congressional intervention because definitive, national enforcement will ensure that the "state's compelling public policy interest in deciding these disputes is…recognized."[136] If more litigation remains in Delaware, the state will benefit financially as well.[137] However, this can only be accomplished by a congressional mandate that many proponents of Delaware's dominance law would reject. As a result, there is a tension: Delaware would benefit from action that will further propagate the "creeping federalization of corporate law."[138]

V. Conclusion

Delaware has a compelling interest in adjudicating shareholder disputes involving the corporations it charters; the United States Supreme Court has made this clear. The "anywhere but Chancery" phenomenon undermines this interest because non-Delaware courts are routinely deciding shareholder suits involving Delaware-chartered corporations.[139] This problem, therefore, must be solved. The intra-corporate forum selection clause, although the best proffered solution, is inadequate without uniform enforcement because the fate of directors and officers will still be left to non-Delaware judges who are less familiar with Delaware corporate law.[140] Congress could provide definitive, uniform enforcement, although this is not without costs.[141] Absent Congressional intervention, which this article does not suggest or support, uniform enforcement of intra-corporate forum selection provisions will depend on developments in case law, with principles such as comity prevailing. Like most common law developments, however, this will take time. On the other hand, it is possible that these provisions will disappear before case law develops sufficiently. For example, shareholders—particularly institutional investors—may disapprove of these provisions so adamantly that corporations determine that the benefit of greater predictability is not worth the increased shareholder dissatisfaction.[142] Regardless of what the future holds, directors and officers, for now, should avoid relying on these provisions to prevent shareholder claims being brought "anywhere but Chancery."

Endnotes

1. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940 (Del. Ch. 2010).
2. *Id.* Ted Mirvis coined the term "Anywhere but Chancery." *See* Ted Mirvis, *Anywhere But Chancery: Ted Mirvis Sounds an Alarm and Suggests some Solutions*, M&A J., at 17 (May 2007) ("It's now twice as likely as it was previous that the [shareholder] litigation will be brought and litigated outside of Delaware.…"). Mirvis explained, "I'm a litigator—and there's only one rule in litigation: Three things matter—location, location, location." *Id.*; *see also* Matthew D. Cain & Steven M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation* 3 (Jan. 2013) (unpublished manuscript), *available at* http://papers.ssrn.com/abstract=1984758 ("Entrepreneurial plaintiffs' attorneys constantly recalibrate the optimal jurisdiction in which to bring litigation… react[ing] to prior court decisions to bring future litigation in the most favorable forum."); Transcript of Motion to Consolidate and Organize Counsel and the Court's Ruling at 19, *In re* Compellent Tech., Inc. S'holder Litig., No. 6084-VCL (Del. Ch. Jan. 12, 2011) (noting one firm that consciously files outside of Delaware).
3. *See infra* note 67 and accompanying text for a discussion of these factors.
4. *See* Sara Lewis, *Transforming the "Anywhere but Chancery" Problem into the "Nowhere but Chancery" Solution*, 14 Stan. J.L. Bus. & Fin. 199, 202 (2008) (arguing that plaintiffs are increasingly bringing shareholder litigation "anywhere but Chancery" in an effort to avoid the benefits that Delaware courts offer litigants); Mirvis, *supra* note 2, at 17 ("[Many] plaintiffs' lawyers [will] not do disclosure-only settlements outside of Delaware because they think they have greater [settlement] power outside of Delaware."); *id.* (arguing that entrepreneurial plaintiffs' counsel seek to file suit where they have increased leverage and greater settlement potential).
5. *See infra* notes 65–66 and accompanying text.
6. *See* John Armour, Bernard Black & Brian Cheffins, *Is Delaware Losing its Cases*? 29 (ECGI, Working Paper No. 151, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1578404 (observing that shareholder suits are increasingly being filed outside Delaware); Lewis, *supra* note 4, at 200 (identifying the rise of multi-jurisdictional litigation); Mirvis, *supra* note 2, at 17 (explaining the "anywhere but Chancery" phenomenon).
7. Some academics have argued that Delaware is losing cases because litigants view the state's bench as overly conservative on awarding fees to plaintiffs' counsel. *See, e.g.*, Mirvis, *supra* note 2, at 17 ("We've talked to the plaintiffs' lawyers in settlements and they will tell you that they have clubbed together, they have made deals with each other, that they have different fee schedules for the 49 states versus the first state.…[T]hey [will] not do disclosure-only settlements outside of Delaware because they think they have greater settlement power outside of Delaware."). Accordingly, some argue that Delaware's judiciary can incentivize plaintiffs' counsel to remain in Delaware by providing larger fee awards. *See* Armour et al., *supra* note 6, at 4 (noting that Delaware courts may have to adjust their approach to awarding attorney's fees because they cannot engage in commentary if they do not have cases, and cases will not be filed in Delaware if attorneys do not anticipate a fee); *see also* Cain & Davidoff, *supra* note 2, at 6 (arguing that entrepreneurial plaintiffs' attorneys constantly recalculate which jurisdiction offers the largest potential fee award). Further, given Chancellor Strine's recent fee award that exceeded $300 million, In re S. Peru Copper Corp., No. CIV.A. 961-CS, 2011 WL 6382006, at *1 (Del. Ch. Dec. 20, 2011), some commentators view this as a signal that more favorable fee awards are on the horizon. *See, e.g.*, Joseph A. Grundfest, *The History and Evolution of Intra-Corporate Forum Selection Clauses: An Empirical Analysis*, 37 Del. J. Corp. L. 333, 334 n.57 (2012) ("[Southern Peru] made it clear that the chancellor wants a certain kind of (legal) business to remain in Delaware.") (alteration in original) (quoting Alison Frankel, *Record $285 ml Fee Award is Strine's Message to Plaintiffs' Bar*, Reuters (Dec. 21, 2011),

http://blogs.reuters.com/alison-frankel/2011/12/21/record-285-ml-fee-award-is-strines-message-to-plaintiffs-bar/.) This article, however, disagrees that *Southern Peru* signals that Delaware will more generously award fees in an effort to keep litigation in the state, because, as others have noted, this approach is misplaced. *See* Armour et al., *supra* note 6, at 42 ("While the 'fix' [of increasing attorneys' fees] seems easy for Delaware courts, there are risks. If Delaware judges explicitly forsake the parsimonious approach to attorney's fees adopted in *Cox Communications Inc.* they will leave themselves vulnerable to the charge that their new stance constitutes an opportunistic and self-serving attempt to build up 'market share' with corporate lawsuits. The Delaware judiciary's collective reputation would be tarnished.").

8. *See* Grundfest, *supra* note 7, at 335 (arguing intra-corporate forum selection clauses are beneficial); Lewis, *supra* note 4, at 199; Edward B. Micheletti & Jenness E. Parker, *Multi-Jurisdictional Litigation: Who Caused this Problem, and Can It Be Fixed?*, 37 DEL. J. CORP. L 1, 24–25 (2012).

9. Armour et al., *supra* note 6, at 2 ("[F]irms incorporating under Delaware law stand to benefit *ex ante* from the guidance offered by the extensive and timely body of precedents generated by prior cases, and *ex post* from the decision-making expertise of the Delaware Court of Chancery judges."); Grundfest, *supra* note 7, at 367 (finding that as of June 30, 2011, over 97 percent of the corporations to adopt an intra-corporate forum selection clause selected the Delaware Court of Chancery).

10. Shareholder claims alleging causes of action that are not governed by state business entity laws would not be covered by these intra-corporate forum selection clauses. Grundfest, *supra* note 7, at 337 n.10. Of note, Chevron Corporation recently amended its forum selection bylaw provision so that litigation can be "brought in 'any state or federal court in the State of Delaware, rather than just the Delaware Court of Chancery,'—an apparent effort 'to ensure the effectiveness of the by-law in light of the Court of Chancery's jurisdictional limitations.'" *Id.* at 364 (citing Chevron Corp., Current Report (Form 8-K) (Mar. 29, 2012)).

11. *See id.* at 38–40 nn.110–18 (discussing how Chevron Corporation's exclusive forum bylaw provision originally followed the language used in the Netsuite IPO).

12. *See* Lewis S. Black, Jr., *Why Corporations Choose Delaware*, DEL. DEP'T OF STATE DIV. OF CORPS. 6 (2007), *available at* http://corp.delaware.gov/whycorporations_web.pdf (internal quotation marks omitted); Lewis, *supra* note 4, at 199 (noting that the "anywhere but Chancery" phenomenon benefits plaintiffs' lawyers by allowing them to increase settlement value out of meritless suits, but it harms shareholders by subjecting their managers and directors to considerable uncertainty in their corporate planning and business decisions).

13. *See supra* note 8 and accompanying text.

14. *In re* Revlon, Inc. S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010).

15. *See* Grundfest, *supra* note 7, at Table A.1 (identifying 133 corporations that have adopted an intra-corporate forum selection clause); Micheletti et al., *supra* note 8, at 18 n.66 (listing the following companies that have adopted intra-corporate forum selection provisions: Primerica Inc., Niska Gas Storage Partners LLC, Intrusion Inc., INPHI Corp., Envestnet Inc., KKR & Co. LP, LLC, Oxford Resource Partners LP, Rhino Resource LP, Swift Holdings Corp., AMN Healthcare Services, Inc., Grand Canyon, Chesapeake Midstream Partners, LP, Gordmans Stores Inc., Furniture Brands International Inc., Charter Communications Inc., TMS International Corp., Chemtura Corp., U.S. Concrete Inc., FXCM Inc., AMERCO, Liberty Mutual Agency Corp., and Chevron Corp.); *see also* Galaviz v. Berg, 763 F. Supp. 2d 1170, 1172 (N.D. Cal. 2011) (noting that Oracle Corp. adopted a forum selection clause).

16. Grundfest, *supra* note 7, at 333.

17. *Id.*

18. *In re Revlon*, 990 A.2d at 960 ("[I]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."); *see supra* note 1 and accompanying text.

19. *Id.*

20. *Galaviz*, 763 F. Supp. 2d at 1175 ("[T]he venue provision was unilaterally adopted by the directors who are defendants in this action, after the majority of the alleged wrongdoing is alleged to have occurred, and without the consent of existing shareholders who acquired their shares when no such bylaw was in effect.").

21. *See infra* Part III.B; Grundfest, *supra* note 7, at 336 n.3 ("The goals of reducing litigation costs and conserving judicial resources have been largely illusory, as enforcement of the forum selection clause has become the object of much litigation."). *But see id.* at 333 ("Forum selection clauses are widely respected and commonly applied across a broad range of commercial and corporate agreements.").

22. *See* Bryan Druzin, *Buying Commercial Law: Choice of Law, Choice of Forum, and Network Externalities,* 18 TUL. J. INT'L & COMP. L. 131, 144 (2009) ("The selection of a neutral forum can give parties 'predictability and certainty about the outcome of the dispute' and 'reduce expenses and delay in the litigation, permitting the parties more promptly to focus on the merits of the case without expensive procedural distractions.'") (quoting Igor Volner, *Forum Selection Clauses: Different Regulations from the Perspective of Cruise Ship Passengers*, 8 EUR. J.L. REFORM 439, 442 (2006)); *see also* Lewis, *supra* note 4, at 199.

23. *Compare Galaviz*, 763 F. Supp. 2d at 1175 (refusing to enforce a forum selection clause adopted by Delaware-chartered corporation Oracle that designated the Delaware Court of Chancery as the exclusive forum), *with In re Revlon*, 990 A.2d at 960 ("[I]f boards and directors and stockholders believe that a particular forum would promote an efficient and value promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes.").

24. If a corporation's clause is not enforced, its directors and officers may be forced to contemporaneously litigate claims. See Grundfest, *supra* note 7, at 381 n.174 where Professor Grundfest explains that *Dias v. Purches* "declin[ed] to stay later-filed Delaware action in favor of Florida actions where the matter involved a Delaware corporate citizen and finding Delaware corporate law would apply." *Dias*, 2012 WL 689160, at *1–2 (Del. Ch. Mar. 5, 2012). *But see* Bushansky v. Armacost, 2012 WL 3276937, at *1, 7 (N.D. Cal. Aug. 9, 2012) (providing an example of where a district court in California granted Chevron's motion to stay the federal action pending resolution of the substantively similar Delaware proceedings).

25. *See infra* Part III.B.

26. *See infra* notes 88–89 and 102 (discussing these costs).

27. *See infra* Part III.B.

28. *See infra* Part IV.A.

29. *See infra* Part IV.B.

30. Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, 26 REGULATION (Spring 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract _id=389403.

31. JOSEPH HELLER, CATCH-22, Simon and Schuster (1st ed. 1961) (coining the term "catch-22").

32. *In re* Revlon, Inc., S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (citing Mirvis, *supra* note 2, at 17).

33. David H. Taylor, *The Forum Selection Clause: A Tale of Two Concepts*, 66 TEMP. L. REV. 785, 785 n.3 (1993) ("The goals of reducing litigation costs and conserving judicial resources have been largely

illusory, as enforcement of the forum selection clause has become the object of much litigation.…[T]hat which was intended to reduce litigation costs has actually served to contribute to them.”).

34. *See infra* Part V.

35. E. Norman Veasey, *What Would Madison Think? The Irony of the Twists and Turns of Federalism*, 34 Del. J. Corp. L. 35, 42–43 (2009) (explaining that Congress has broad powers under the Commerce Clause to usurp corporate law from the states). See *infra* Part IV.A for a discussion of Sarbanes-Oxley and Dodd-Frank, two of the most recent Congressional intrusions into corporate governance.

36. Armour et al., *supra* note 6, at 1 (noting that more than four out of five U.S. public companies that choose to be incorporated under the laws of a state other than their home state select Delaware).

37. Grundfest, *supra* note 7, at 374 n.136 (finding, between 1993 and 2009, 58 percent of S&P 1,500 firms were incorporated in Delaware) (citing Murali Jagannathan & Adam C. Pritchard, *Delaware Incorporation and Managerial Entrenchment* 10–11, 34 tbl.1 (U. Mich. L. & Econ., Olin Working Paper No. 08-024, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1313274). Also, over 80 percent of public companies that choose to incorporate outside of their headquarters state select Delaware. *See id.* (citing Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 Yale L.J. 553, 567 tbl.2, 578 tbl.5 (2002)).

38. State of Delaware Department of Finance Office of the Secretary: Financial Overview 2011, *available at* http://finance.delaware.gov/publications/Monthly/2011/02_11.pdf.

39. *See* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251, 254–57 (1977); William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L.J. 663, 700–01 (1974); Daniel R. Fischel, *The “Race to the Bottom” Revisited: Reflections on Recent Developments in Delaware’s Corporation Law*, 76 Nw. U. L. Rev. 913, 915 (1982).

40. Cary, *supra* note 39, at 700–01.

41. *Id.* at 697–701; J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in Governance of Public Companies*, 38 U. Rich. L. Rev. 317, 317 (2004).

42. Brown, *supra* note 41, at 317 (arguing that Sarbanes-Oxley was insufficient and more federal involvement is necessary to stop the “race to the bottom”).

43. Winter, *supra* note 39, at 254–57.

44. *See* Fischel, supra note 39, at 915 (arguing that the race to the bottom thesis is based on a fundamental misunderstanding of the law); Roberta Romano, The Genius of American Corporate Law 4–6 (1993).

45. *See, e.g.*, Winter, *supra* note 39, at 254–57.

46. Stephen Bainbridge, *Does State Corporate Law Really Race to the Top*, Bainbridge.com (Sept. 19, 2003), http://www.professorbainbridge.com/professorbainbridgecom/2003/09/does-state-corporate-law-really-race-to-the-top.html.

47. *Id.* See Winter, *supra* note 39, at 254–57, for a discussion of the race to the top theory.

48. Bainbridge, *supra* note 46.

49. *See, e.g.*, *id.*

50. Omari Scott Simmons, *Branding the Small Wonder: Delaware’s Dominance and the Market for Corporate Law*, 42 U. Rich. L. Rev. 1129, 1163 (2008) (“The Court of Chancery has a national reputation for its sophistication and expertise in handling corporate cases. The special attributes of the Court of Chancery’s adjudication are its speed and expertise, which require experience. In a sense, the Chancery Court functions as a quasi-arbitrator, whose services are purchased via Delaware incorporation.”); Mark J. Roe, *Delaware’s Competition*, 117 Harv. L. Rev. 588, 588 (2003) (noting that Delaware has a highly specialized and highly regarded judiciary).

51. *In re* Topps Co. S’holders Litig., 924 A.2d 951, 959 n.24 (Del. Ch. 2007).

52. *See id.*

53. *See, e.g.*, Randy J. Holland, *Delaware’s Business Courts: Litigation Leadership*, 34 J. Corp. L. 771, 773 (2009).

54. *Id. See also* Armour et al., *supra* note 6, at 2 (“[F]irms incorporating under Delaware law stand to benefit *ex ante* from the guidance offered by the extensive and timely body of precedents generated by prior cases, and *ex post* from the decision-making expertise of the Delaware Court of Chancery judges.”). But see Nemec v. Shrader, 991 A.2d 1120, 1131 (Del. 2010) and Americas Mining Corp. v. Theriault, 51 A.3d 1213, 1263 (Del. 2012), *reargument denied* (Sept. 21, 2012), for two recent decisions where dissenting opinions were filed.

55. *See* Holland, *supra* note 53, at 778–79.

56. *Id. See also* Armour et al., *supra* note 6, at 29.

57. *See* Edgar v. Mite Corp., 457 U.S. 624, 645 (1982) (“The internal affairs doctrine is a conflict of laws principle which recognizes that only one state should have the authority to regulate a corporation’s internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.”).

58. *See* Holland, *supra* note 53, at 786 (discussing the implications of the internal affairs doctrine); Lewis, *supra* note 4, at 200.

59. Holland, *supra* note 53, at 781 (alteration in original) (emphasis added) (internal quotation marks omitted).

60. *See, e.g.*, Lewis, *supra* note 4, at 201 (identifying circumstances when a California court would not apply Delaware law).

61. *See, e.g.*, VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112–13 (Del. 2005) (“It is now well established that only the law of the state of incorporation governs and determines issues relating to a corporation’s internal affairs.”); Grundfest, *supra* note 7, at 337 n.10 (“Each corporation is formed under the law of its chosen state of incorporation. To ensure consistency and predictability, that law must govern the corporation’s internal affairs.”) (citing Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. Corp. L. 33, 35 (2006)).

62. Armour et al., *supra* note 6, at 29; *see also* Edgar v. Mite Corp., 457 U.S. 624, 645 (1982) (“[O]nly one [s]tate should have the authority to regulate a corporation’s internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands.”).

63. *Id. See also* Cain & Davidoff, *supra* note 2, at 3 (“Entrepreneurial plaintiffs’ attorneys constantly recalibrate the optimal jurisdiction in which to bring litigation…react[ing] to prior court decisions to bring future litigation in the most favorable forum.”).

64. See *supra* notes 2–4 and *infra* note 67 (identifying reasons that make litigation outside of Delaware less certain and more risky for corporate-defendants).

65. *See, e.g.*, Armour et al., *supra* note 6, at 29 (noting the risk of non-Delaware forums misapplying Delaware corporate law).

66. This result is intuitive. However, given that the Court of Chancery is notoriously “reasonable” with fee awards, *see supra* note 7, upon doing a calculation, plaintiffs may often find that other forums offer greater value. *See* John Armour, Bernard Black & Brian Cheffins, *Delaware’s Balancing Act*, 87 Ind. L. J. 1345, 1370 (2012) (“In *Cox Communications*, Chancellor Strine cut the fee requested by plaintiffs’ lawyers by 75%. In *Revlon*, Vice Chancellor Laster took a case away from lead counsel entirely, presumably dashing their fee hopes as well.”); *Id.* (“Delaware courts scrutinize

fee requests closely, but elsewhere judges routinely approve fee awards, at least if the defendant does not object. A 2011 ruling by Vice Chancellor Laster…confirms the point, as he acknowledged that plaintiffs' lawyers, aware that Delaware courts would likely only award attorneys' fees of '$400,000 or $500,000' for the case, could reason 'let's go to Florida and get $1 million.'") (citing Status Conference, at 9, *In re* Burger King Holdings, Inc., S'holders Litig., No. 5808-VCL (Del. Ch. Jan. 19, 2011)). But see *In re* Southern Peru Copper Corp. S'holder Deriv. Litig., 2011 WL 6382006, at *1 (Del. Ch. Dec. 20, 2011), where Chancellor Strine recently awarded over $300 million in attorneys' fees because he found that plaintiffs' counsel conferred significant benefits to the class.

67. *See* Micheletti et al., *supra* note 8, at 5–14; Lewis, *supra* note 4, at 199; Cain & Davidoff, *supra* note 2, at 6. In addition to the danger that non-Delaware forums will misapply Delaware law and reach a holding inconsistent with its proper interpretation, other factors that push shareholder litigation "anywhere but Chancery" include, but are not limited to: (1) The Delaware Court of Chancery does not allow attorney fees to be discussed contemporaneously with settlement negotiations, unlike most other jurisdictions. *See, e.g.*, Transcript of Settlement Conference and Plaintiffs' Application for Attorneys' Fees at 49–50, *In re* Clarient, Inc. S'holders Litig., No. 5932-VCS (Del. Ch. June 15, 2011) ("[T]he practice in California is different than the Delaware practice,…in California, like many other jurisdictions outside of Delaware, discussions regarding fees contemporaneous with the discussion of the agreement in principle for the settlement are permissible."); (2) Some academics have argued that Delaware is losing cases because litigants view the state's bench as overly conservative on awarding fees to plaintiffs' counsel. *See supra* note 7; (3) Unlike other forums, the Court of Chancery also does not offer a potential for jury trials or punitive damages. See Beals v. Washington Int'l Inc., 386 A.2d 1156, 1160 (Del. Ch. 1978), where the Delaware Supreme Court stated that the decision for a court to have authority to award punitive damages is clearly a policy decision and the Court of Chancery will not award punitive damages absent legislative direction. See Armour et al., *supra* note 6, at 29, where respected corporate law scholars John Armour, Bernard Black & Brian Cheffins explained that having a jury gives plaintiffs more leverage over corporate-defendants; (4) Plaintiffs with weak cases file outside of Delaware because non-Delaware courts are not as efficient and therefore take longer to adjudge a claim, which correspondingly permits more time to pressure the defendant into settlement. *See* Simmons, *supra* note 50, at 1164 ("'Few if any courts can match the speed'…of the Court of Chancery in adjudicating corporate matters.").

68. *See, e.g.*, Armour et al., *supra* note 6, at 29.

69. *See infra* note 80 and accompanying text; *In re* Topps Co. S'holders Litig., 924 A.2d 951, 959 (Del. Ch. 2007).

70. *In re Topps*, 924 A.2d at 959 (emphasis added).

71. Mirvis, *supra* note 2, at 17; Armour et al., *Delaware's Balancing Act*, *supra* note 66, at 1363 (citing David Marcus, *Did Chancery Fee Rulings Chase Away Plaintiffs Lawyers?*, DEL. L. WKLY., Nov. 29, 2006).

72. *See, e.g.*, Mirvis, *supra* note 2, at 17.

73. Armour et al., *Delaware's Balancing Act*, *supra* note 66, at 1350.

74. *Id.*

75. Mirvis, *supra* note 2, at 18 (arguing that this is the best solution to keep litigation within Delaware); *see generally* Grundfest, *supra* note 7 (providing an impressive compilation of forum selection clause data).

76. A forum selection clause can be adopted in the corporation's charter or bylaws. Section 109(a) of the Delaware General Corporation Law permits bylaws to be amended by a majority shareholder vote. DEL. CODE ANN. tit. 8, § 109(a) (2001); Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 132 (2009). *Cf.* Galaviz v. Berg, 763 F. Supp. 2d 1170, 1174–75 (N.D. Cal. 2011) (explaining a forum selection clause is more likely to be upheld if it is adopted by a majority of the shareholders). For a discussion of issues that the state courts cannot hear, see *supra* note 10.

77. *See supra* note 22.

78. *See* Simmons, *supra* note 50, at 1163 ("In a sense, the Chancery Court functions as a quasi-arbitrator, whose services are purchased via Delaware incorporation."); *see also* Armour et al., *Delaware's Balancing Act*, *supra* note 66, at 1347 (explaining that corporations pay a significant premium in the form of franchise fees and taxes to be a Delaware-chartered corporation) (citing Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1210–11 (2001)).

79. See Simmons, *supra* note 50, at 1165 ("[U]nlike other states where corporate cases are heard by numerous judges in courts of general jurisdiction, Delaware limits corporate litigation to two courts and ten judges. Some commentators contend this creates greater stability and predictability."); *see also* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 712 (2002) (explaining that other states, unlike Delaware, do not have courts that specialize in corporate law disputes).

80. Transcript of Motion to Consolidate and Organize Counsel and the Court's Ruling at 15, *In re* Compellent Tech., Inc. S'holder Litig., C.A. No. 6084-VCL (Jan. 2, 2011).

81. *See* Edgar v. Mite Corp., 457 U.S. 624, 645 (1982) (emphasis added); *In re* Topps Co. S'holders Litig., 924 A.2d 951, 958 (Del. Ch. 2007).

82. Armour et al., *supra* note 6, at 3 ("[T]he internal affairs doctrine does not…ensure that Delaware will be the chosen forum."); *id.* at 29 ("[P]laintiffs' lawyers have considerable leverage [before] a non-Delaware court because there is a potential that the court will misapply Delaware law."): *see, e.g.*, Micheletti et al., *supra* note 8, at 26–32 (discussing the costs and disadvantages associated with multi-jurisdictional litigation).

83. Holland, *supra* note 53, at 781 (emphasis added).

84. *See, e.g.*, Micheletti & Parker, *supra* note 8, at 25 ("One concern about these provisions is that they have not yet been fully tested in the Courts.…There is also a risk that courts in states that are not the designated forum for resolving the dispute will not abide by the provisions, leading to uncertainty.").

85. *See id.*

86. *See, e.g.*, *id.* at 26–30.

87. *Compare* Galaviz v. Berg, 763 F. Supp. 2d 1170, 1175 (N.D. Cal. 2011) (refusing to enforce Delaware-chartered corporation Oracle's forum selection clause), *with In re* Revlon, Inc., S'holders Litig., 990 A.2d 940, 960 (Del. Ch. 2010) (suggesting that intra-corporate forum selection clauses may prevent "frequent filer" plaintiffs).

88. *See* Grundfest, *supra* note 7, at 335–36 n.3 (quoting Taylor, *supra* note 33, at 785 n.3) ("'[T]he goals of reducing litigation costs and conserving judicial resources have been largely illusory, as enforcement of the forum selection clause has become the object of much litigation.'"); *see also id.* (quoting Taylor, *supra* note 33, at 785 n.3) ("'[T]hat which was intended to reduce litigation costs has actually served to contribute to them.'"). *See also* Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1078 (2000) ("[L]itigation costs can be large and create a deadweight loss for shareholders and society.").

89. *See, e.g.*, Charles M. Nathan et al., *Goodman: Designating Delaware's Court of Chancery as the Exclusive Jurisdiction for Intra-Corporate Disputes*, INSIGHTS: CORP. & SEC. L. ADVISOR, at 3 (June 2010) (explaining a risk of adopting a forum selection clause is that multiple jurisdictions will determine their enforceability, which will lead to inconsistent results).

90. Grundfest, *supra* note 7, at 335 ("Forum selection clauses are widely respected and commonly applied across a broad range of commercial and corporate agreements.").

91. *See Galaviz*, 763 F. Supp. 2d at 1172 ("[N]o court has previously ruled on the enforceability of a venue provision for derivative actions contained in corporate bylaws. Such bylaws are reportedly a recent phenomenon, apparently occasioned by a passing comment in *In re* Revlon, Inc., Shareholders Litigation….").

92. *See id.* at 1171.

93. *See id.* at 1175 ("Certainly were a majority of shareholders to approve such a charter amendment, the arguments for treating the venue provision like those in commercial contracts would be much stronger, even in the case of a plaintiff shareholder who had personally voted against the amendment.").

94. See *id.* at 1171–72, noting the fraudulent and improper practices Oracle conducted between 1998 and 2006 involved the sale "of software and licenses to the United States government totaling some $1.08 billion…" and by failing to apply certain discounts to which the government was contractually and legally entitled.

95. *See id.* at 1172.

96. *Id.* at 1174 (emphasis added).

97. *See id.* at 1175.

98. *See* Grundfest, *supra* note 7, at 345 n.58 (citing the cases).

99. *Id.* at 71, 346 n.60 (citing the cases).

100. Verified Shareholder Derivative Complaint, Case No. 7490, at ¶¶124, 127, 131, 135 (May 3, 2012), *available at* http://graphics8.nytimes.com/news/business/walmart-shareholder-complaint.pdf.

101. Grundfest, *supra* note 7, at 349. For examples where courts have refused to enforce forum selection clauses on policy grounds, see *id.* at 349 n.64 (citing over twenty instances).

102. *Id.* at 390 ("[I]f shareholders express sufficient opposition to forum selection provisions, then boards of directors may conclude that the game is not worth the candle because the governance costs of adopting forum selection provisions may exceed the litigation benefits.").

103. The United States Supreme Court has ruled on the enforceability of forum selection clauses in the non-corporate law context on multiple occasions. In *Bremen v. Zapata Off-Shore Co.*, the Court held that forum selection clauses, although not "historically favored," are "*prima facie* valid," and went on to state that "a freely negotiated private agreement, unaffected by fraud, undue influence, or overweening bargaining power…should be given full effect." Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12–13 (1972). Nearly two decades after *Bremen* was decided, the Supreme Court addressed the enforceability of a forum selection clause again in *Carnival Cruise Lines, Inc., v. Shute*. *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 587 (1991). The forum selection clause at issue in *Carnival Cruise Lines, Inc.* was included in fine print on the back of the respondents' cruise passenger ticket. *Id.* at 593. The Court held the forum selection clause was enforceable because it was present when the respondents purchased their ticket, and according to fundamental contract law they assented to the clause by using the ticket. *See id.* at 593–95 ("There is no evidence that petitioner obtained respondents' accession to the forum clause by fraud or overreaching. [R]espondents were given notice of the forum provision and, therefore, presumably retained the option of rejecting the contract with impunity."). Notably, however, the forum selection clauses at issue in *Bremen* and *Carnival Cruise Lines* were both present when the plaintiffs entered into the agreement. *See Carnival Cruise Lines, Inc.*, 499 U.S. at 587; *Bremen*, 407 U.S. at 11. Considering that many *current* corporations are *amending* their charters or bylaws to adopt forum selection clauses, this poses a substantial risk that, if the Court were to decide the issue, it would distinguish those previous cases where the clause was integrated within the agreement from its inception, and would hold that the corporation's clause is unenforceable if it was adopted without shareholder consent. *See, e.g.*, Galaviz, 763 F. Supp. 2d. at 1172 (refusing to enforce Delaware-chartered corporation Oracle's forum selection clause because it was adopted by amendment without consent).

104. Veasey, *supra* note 35, at 42–43 ("[T]he courts have made it quite clear…that federal courts and agencies, as well as the SEC, are not at liberty to fashion a kind of federal common law of corporations, or otherwise to trump state law, unless Congress expressly so provides.").

105. Bainbridge, *supra* note 30, at 26; Veasey, *supra* note 35, at 42–43.

106. *See* Veasey, *supra* note 35, at 42 (citing Arthur Fleischer, Jr., *"Federal Corporation Law": An Assessment*, 78 Harv. L. Rev. 1146, 1153 (1965)) ("The federal securities laws affect a wide range of corporate activities, but generally they do not preempt complementary state laws; they are pervasive but not exclusive.").

107. Jill E. Fisch, *Leave it to Delaware: Why Congress Should Stay Out of Corporate Governance*, 37 Del. J. Corp. L. 731, 733 (2013); William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 Wake Forest L. Rev. 619, 624 (2006) ("Congress could draw on the same Commerce Clause on which it draws in supplementing the state system to occupy the entire field of corporate law.").

108. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

109. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of U.S.C.).

110. Fisch, *supra* note 107, at 733.

111. *Id.* (citing § 906, 116 Stat. at 806 (codified as amended at 18 U.S.C. § 63 (2006))).

112. *Id.* (citing § 202, 116 Stat. at 772 (codified as amended at 15 U.S.C. § 78j-1 (2006))).

113. Jean C. Bedard et al., *Sarbanes-Oxley Section 404 and Internal Controls A Look at Two Years of Compliance*, CPA Journal (Oct. 2007), *available at* http://www.nysscpa.org/cpajournal/2007/1007/essentials/p34.htm.

114. Fisch, *supra* note 107, at 734 (citing § 402, 116 Stat. at 787 (codified as amended at 15 U.S.C. § 78m (2006))).

115. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521 (2005); Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 Va. L. Rev. 685, 694 (2009); *see also* Stephen M. Bainbridge, *Quack Corporate Governance Round II*, 95 Minn. L. Rev. 1779, 1780–82 (2012).

116. Bainbridge, *supra* note 115, at 1780–81.

117. *Id.*

118. *See, e.g.*, Fisch, *supra* note 107, at 734

119. *E.g.*, *id.*

120. § 951, 124 Stat. at 1899 (codified as amended at 15 U.S.C. § 78n-1 (2006)).

121. § 971, 124 Stat. at 1915 (codified as amended at 15 U.S.C. § 78n (2006)). The SEC adopted proxy access as a rule. Fisch, *supra* note 107, at 734 n.17, 758–764. Marcel Kahan and Edward Rock provide a thorough account of the pitfalls associated with proxy access. *See* Marcel Kahan & Edward Rock, *The Insignificance of Federal Proxy Access*, 97 Va. L. Rev. 1347, 1347–48 (2011).

122. § 951, 124 Stat. at 1899 (codified as amended at 15 U.S.C. § 78n-1 (2006)).

123. 17 C.F.R. § 229.402(b)(1)(vii).

124. Fisch, *supra* note 107, at 40 (citing Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 Emory L.J. 435, 499–500 (2012)).

125. 17 C.F.R. § 240.14a-11 (2012).

126. Bus. Roundtable v. SEC, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

127. *Id.* at 1156.

128. Fisch, *supra* note 107, at 42 (citing Fisch, *supra* note 124, at 476) (discussing 17 C.F.R. § 240.14a-11).

129. *Id.* at 45–46.

130. *See* Bainbridge, *supra* note 30.

131. *See generally* Fisch, *supra* note 107 (arguing that Congress should "leave it to Delaware" and abstain from further interference in corporate law).

132. *See id.* at 26 ("The nine most terrifying words in the English language are: I'm from the government and I'm here to help.") (internal quotation marks omitted); Bainbridge, *supra* note 30, at 31 ("Congress should back off.").

133. Heller, *supra* note 31.

134. *See supra* notes 39–42 and accompanying text (describing Delaware's failure and the race to the bottom theory).

135. Heller, *supra* note 31.

136. *In re* The Topps Co. S'holders Litig., 924 A.2d 951, 959 (Del. Ch. 2007).

137. *See supra* notes 35–38 and accompanying text (explaining that Delaware's economy depends on maintaining its dominance in corporate governance).

138. *See* Bainbridge, *supra* note 30.

139. *See supra* Part II.B.

140. *See supra* notes 84–101 and accompanying text.

141. *See supra* notes 129–137 and accompanying text.

142. Grundfest, *supra* note 7, at 71 ("[A]s a governance matter, if shareholders express sufficient opposition to forum provisions, then boards of directors may conclude that the game is not worth the candle because the governance costs of adopting forum selection provisions may exceed the litigation benefits.").

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Inside the Courts

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UNITED STATES SUPREME COURT

Class Certification

Supreme Court Holds Securities Fraud Plaintiffs Are Not Required to Prove Materiality of Allegedly False Statements to Certify a Class

***Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013)**

In a 6-3 decision, the Supreme Court of the United States held that a securities fraud plaintiff alleging fraud on the market need not establish the materiality of an alleged fraudulent statement in order to obtain class certification. Justice Ginsburg delivered the opinion of the Court, and Justices Scalia, Thomas and Kennedy dissented.

The particular questions presented by the Supreme Court's grant of *certiorari* were whether, in a misrepresentation case under SEC Rule 10b-5, a securities fraud plaintiff alleging fraud on the market must establish the materiality of the misstatements in order to obtain class certification and whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

The Supreme Court held that establishing the materiality of the alleged fraudulent statement is not necessary; it is enough to show that the security in question was traded in an efficient market and that the alleged fraudulent statement became public. Having made that showing, the plaintiff could invoke the fraud-on-the-market presumption of reliance and thus represent a class of shareholders. The Court explained that "Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class.… The alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class." The Supreme Court further held that rebuttal of the fraud-on-the-market presumption of reliance is appropriate at the class certification stage if it would disprove commonality of the class members' reliance; rebuttal evidence on materiality does not disprove commonality.

The Supreme Court's holding affirmed the U.S. Court of Appeals for the Ninth Circuit, resolving an existing split between the First, Second and Fifth Circuit Courts of Appeals and the Third, Seventh and Ninth Circuit Courts of Appeals.

Statutes of Limitations

Supreme Court Rejects Discovery Rule on Statute of Limitations for SEC Civil Penalty Enforcement Actions

***Gabelli v. SEC*, 133 S. Ct. 1216 (2013)**

In a unanimous opinion authored by Chief Justice Roberts, the U.S. Supreme Court held that the five-year limitations period that governs SEC enforcement actions begins to run when the alleged fraud is complete. The Court reversed the Second Circuit on the issue, which had held that the discovery rule applied in cases where the defendant allegedly committed fraud. The SEC alleged that two mutual fund managers allowed one of the fund's investors to engage in market timing in the fund in exchange for an investment in a separate hedge fund, but the SEC filed the action more than five years after the conduct was alleged to have taken place. The Court explained that limitations periods ordinarily begin to run upon a party's injury, but in cases of fraud—when the injury itself is concealed—courts have developed the discovery rule to protect individuals, who are after all not required to be in a constant state of investigation. That rationale, however, does not apply to the SEC, whose mission is to investigate (and prevent) fraud and which has statutory authority to demand detailed records, including through extrajudicial subpoenas. Therefore, the Court concluded the discovery rule does not apply to the SEC.

CLASS CERTIFICATION

Virginia Court Certifies Class in Federal Securities Fraud Action

***In re Computer Scis. Corp. Sec. Litig.*, 288 F.R.D. 112 (E.D. Va. 2012)**

Judge Thomas Ellis of the U.S. District Court for the Eastern District of Virginia certified a stockholder class in a case brought pursuant to section 10(b) of the Securities Exchange Act. The action dated to June 3, 2011, when the City of Roseville Employee's Retirement System filed a complaint alleging that defendant Computer Sciences Corporation ("CSC") had violated the federal securities laws by making false and misleading statements about a major contract and CSC's internal controls. Subsequently, the court consolidated that action with three similar cases, naming Ontario Teachers' Pension Plan the lead plaintiff.

In certifying the class, the court rejected arguments that defendants have brought in a number of recent cases in an effort to defeat the presumption of reliance due to market efficiency for widely traded common stocks. The court held that Ontario Teachers had adequately demonstrated the existence of an efficient market for the defendant's stock. Notably, CSC shares traded on the New York Stock Exchange, a fact that—although not itself dispositive—weighed heavily in favor of a finding of market efficiency. Moreover, during the relevant time, the company had more than 155 million shares outstanding, an average weekly trading volume of 4 percent, and the attention of some 39 Wall Street analysts, who authored more than 300 class-period reports on the company. The court rejected the defendant's argument that the plaintiffs were obliged to present an event study to show a causal relationship between the alleged misstatements and movements in the defendant's stock price.

In the opinion, the court also granted a motion to appoint Ontario Teachers as lead plaintiff—again rejecting arguments that defendants often try to develop in opposing certain institutional lead plaintiffs. The court reasoned that—although Ontario Teachers employed somewhat notable trading strategies, including trading on perceived market "inefficiencies"; purchased shares in the defendant's stock following the close of the class period; and owed duties to its own investors—it nevertheless shared the interests and injuries of other class members. Moreover, held the court, any unique defenses to the claims of Ontario Teachers were not likely to become the focus of the litigation. Thus, the court held that Ontario Teachers satisfied the typicality and adequacy requirements of Federal Rules of Civil Procedure 23(a)(3) and (4).

DIRECTORS AND DIRECTORS' DUTIES

Derivative Litigation

Ninth Circuit Certifies Dispositive Question of Delaware Law to the Supreme Court of Delaware

***Arkansas Teacher Ret. Sys. v. Mozilo*, 705 F.3d 973 (9th Cir. 2013)**

In this shareholder derivative action, five investors sued on behalf of former Countrywide Financial Corporation, asserting claims for breach of fiduciary duty and securities law violations against former Countrywide officers and directors. While the suit was pending, Countrywide merged into a wholly owned subsidiary of Bank of America Corporation in a transaction that divested the plaintiffs of their Countrywide shares. Countrywide moved for judgment on the pleadings, arguing the plaintiffs no longer had standing to pursue derivative claims because the shareholders did not continuously hold Countrywide shares. The district court granted the motion, holding the plaintiffs could not satisfy the "continuous ownership" requirement for shareholder derivative standing under Federal Rule of Civil Procedure 23.1 and Delaware law. The plaintiffs argued that under *Arkansas Teacher Retirement Systems v. Caiafa*, 996 A.2d 321 (Del. 2010), they retained post-merger derivative standing under the fraud exception to the continuous ownership requirement. Countrywide argued that under *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984), reaffirmed by *Arkansas Teacher*, the fraud exception to the continuous ownership requirement applies only when the plaintiffs allege that the merger was executed merely to destroy derivative standing, and that the plaintiffs did not so allege. The U.S. Court of Appeals for the Ninth Circuit, reviewing the district court's order granting the defendant's motion for judgment on the pleadings and denying the plaintiffs' motion for reconsideration, certified the following question to the Supreme Court of Delaware:

> Whether, under the "fraud exception" to Delaware's continuous ownership rule, shareholder plaintiffs may maintain a derivative suit after a merger that divests them of their ownership interest in the corporation on whose behalf they sue by alleging that the merger at issue was necessitated by, and is inseparable from, the alleged fraud that is the subject of their derivative claims.

Mergers and Acquisitions

Delaware Supreme Court Affirms in Part and Reverses in Part Decision Approving Settlement of Litigation Regarding Celera Sale

***In re Celera Corp. S'holder Litig.*, 59 A.3d 418 (Del. 2012)**

The Delaware Supreme Court affirmed in part and reversed in part the Delaware Court of Chancery's decision approving a settlement in *In re Celera Corp. Shareholder Litigation*, No. CIV.A. 6304-VCP, 2012 WL 1020471 (Del. Ch. Mar. 23, 2012). Vice Chancellor Donald F. Parsons Jr. of the Delaware Court of Chancery had previously overruled an objection and approved the settlement of litigation challenging a two-step merger transaction. During briefing on a motion for a preliminary injunction, Celera Corporation entered into a memorandum of understanding with the lead plaintiff, New Orleans Employees' Retirement System ("NOERS"), which contemplated a settlement of class claims for therapeutic benefits, including the modification of deal protection devices and additional disclosures, but no increase in the merger price. Celera's largest shareholder objected to the settlement because it believed the merger price was too low, and that NOERS—which had sold its Celera shares for a slight premium shortly after executing the memorandum of understanding, but before the deal closed through the second-step short-form merger—was an inadequate class representative. The Court of Chancery found, however, that NOERS satisfied the adequacy of representation requirements of Rule 23, "albeit barely," calling NOERS's decision to sell its shares before the merger closed "careless and cavalier."

The objector appealed the Court of Chancery's decision, challenging three aspects of the lower court's ruling: (i) the certification of NOERS as lead plaintiff; (ii) the approval of the settlement without an opt-out right; and (iii) the fairness of the settlement itself, arguing that the settlement unfairly forced the objector to forgo a valuable claim for scant consideration. The Delaware Supreme Court affirmed the Court of Chancery's ruling that the plaintiff was an adequate representative. The Delaware Supreme Court, however, found that the Court of Chancery erred in denying the objector a discretionary opt-out right, based on the facts that the representative was "'barely' adequate," the objector was a significant shareholder (holding an approximately 24.5 percent stake at the time the merger closed) and was prepared to prosecute a "supportable claim for substantial money damages, and the only claims realistically being settled at the time of the certification hearing nearly a year after the merger were for money damages." Accordingly, "[u]nder these particular facts and circumstances, the Court of Chancery had to provide an opt-out right." The Delaware Supreme Court did not reach the objector's challenge to settlement approval because of its holding that the objector should have been permitted to opt out.

Court of Chancery Dismisses Allegations Arising Out of Attachmate Acquisition by Merger of Novell

***In re Novell, Inc. S'holder Litig.*, No. CIV.A. 6032-VCN, 2013 WL 53901 (Del. Ch. Jan. 3, 2013)**

Vice Chancellor John W. Noble of the Delaware Court of Chancery dismissed nearly all of the allegations asserted against the Novell board arising out of Attachmate Corporation's 2011 acquisition by merger of Novell, Inc. The court dismissed allegations that (i) the included deal protections were a violation of fiduciary duty, (ii) the CEO's severance agreements constituted an improper interest, (iii) a banker used artificially low projections and was conflicted, (iv) a minority shareholder dominated and controlled the board process, (v) proxy disclosures were misleading, (vi) a related sale of Novell's patent portfolio at an allegedly too-low price was a breach of fiduciary duty, and (vii) the board violated Del. Code tit. 8, § 251(b) in approving the merger. The court also found that the plaintiffs had failed to allege that any member of the nine-member board was improperly interested or lacked independence (the plaintiffs had challenged only two of the nine members), and that the board was exculpated from monetary liability for any breach of the duty of care by operation of Del. Code tit. 8, § 102(b)(7). The court also found that the eight-month process leading to the all-cash premium merger—a process that included contacting dozens of potential buyers—"far exceeded" the standard articulated in *Lyondell Chemical Co. v. Ryan* for stating a bad-faith claim in the *Revlon* context.

Nevertheless, the court permitted a small subset of the plaintiffs' bad-faith allegations to survive. According to the court, the plaintiffs had alleged, among other things, that the board never permitted a potential bidder ("Party C") to partner with other buyers, even though Attachmate had been permitted to do so, and that the board never followed up with Party C following the negotiated sale of the company's patent portfolio. The plaintiffs alleged that if the board had done so, Party C might have increased its bid. The court held that these facts were unexplained on the current record, and if left unexplained could constitute bad faith, because bad faith can be found where a fiduciary's actions are "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." In so holding, the court noted that at the pleading stage the board had not had a chance to "prove its case," and that a number of valid reasons could exist for the board's decisions during the sales process.

DISCOVERY

New Jersey Court Affirms Decision That Voluntarily Producing Documents to Justice Department Waived Attorney-Client Privilege in Unrelated Private Action

***In re Merck & Co., Inc. Sec., Derivative & "Erisa" Litig.*, No. MDL 1658 SRC, 2012 WL 6840532 (D.N.J. Dec. 20, 2012)**

In an opinion labeled "Not for Publication," Judge Stanley R. Chesler of the U.S. District Court for the District of New Jersey affirmed a magistrate judge's decision that voluntarily producing documents to the Department of Justice in connection with an investigation waived the attorney-client privilege and work product protection in an unrelated private action. Merck had voluntarily produced the documents to the Department of Justice under an agreement that its limited waiver of any protection offered by the attorney-client privilege or work product doctrine would not extend to any third party and requiring the Government to maintain the documents' confidentiality. Applying *Westinghouse v. Republic of the Philippines*, 951 F.2d 1414 (3d Cir. 1991), the court held that the waiver was ineffective because selective waivers do not promote the public policy interests traditionally attributed to privilege.

EXCHANGE ACT

Second Circuit Affirms Dismissal, Finds Pharmaceutical Company Had No Duty to Disclose Contradictory Details in Press Release About Drug in Testing Stage

***Kleinman v. Elan Corp.*, 706 F.3d 145 (2d Cir. 2013)**

The U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that a pharmaceutical company violated section 10(b) of the Securities Exchange Act by allegedly issuing a press release about a drug in the testing stage without disclosing certain contradictory details, because the company had no duty to disclose the information. Although the company released a subsequent press release that allegedly contradicted the initial report's positive statements, the alleged representations about the drug's efficacy were subjective rather than definitive and therefore were intentional puffery, and the alleged omissions regarding the company's testing procedure were not necessary for investors to understand the testing methods implemented. In addition, the court held that the decline in the company's stock price following the second press release was insufficient to show that the second press release was a corrective disclosure of a prior misrepresentation, because other factors may have influenced investors' decisions.

EXPERT WITNESSES

SDNY Denies Challenge to Methodology for Testing Whether Underwriting Standards Were Correctly Applied in Loans Underlying Mortgage-Backed Securities

***Fed. Hous. Fin. Agency v. JPMorgan Chase & Co.*, No. 11 Civ. 6188 (DLC), 2012 WL 6000885 (S.D.N.Y. Dec. 3, 2012)**

Judge Denise Cote of the U.S. District Court for the Southern District of New York denied a *Daubert* challenge to a report tendered by the Federal Housing Finance Agency on behalf of Fannie Mae and Freddie Mac. To avoid testing whether underwriting standards were correctly applied in all 1.1 million loans underlying the mortgage-backed securities at issue, a statistical expert tested a small sample of loans from each securitization for compliance with the disclosed underwriting standards using statistical techniques to ensure that loans with high and low credit scores were equally likely to be selected. In finding that the statistical analysis satisfied the standard for scientific evidence under *Daubert*, the court held that the expert's methodology was reliable and that the objections—in large part, the difficulty of consistently replicating the results and the higher margin of error within samplings of certain securitizations—properly go to the weight of the expert's testimony (an issue for the jury) rather than to its admissibility.

FRAUD-ON-THE-MARKET THEORY

Oregon Supreme Court Determines Stock Purchaser Who Purchases Stock on Efficient, Open Market May Establish Reliance by Means of Fraud-on-the-Market Presumption

***State v. Marsh & McLennan Cos., Inc.*, 292 P.3d 525 (Or. 2012)**

The Supreme Court of Oregon, in reversing the summary judgment decision of the trial court and the Oregon Court of Appeals, concluded that under Or. Rev. Stat. § 59.137, a stock purchaser who purchases stock on an efficient, open market may establish reliance by means of the fraud-on-the-market presumption.

The state of Oregon, on behalf of the Oregon Public Employee Retirement Fund, asserted claims against Marsh & McLennan Companies, Inc. and Marsh, Inc. (collectively, "Marsh"), alleging that a scheme perpetrated by false and misleading statements, in violation of Or. Rev. Stat. §§ 59.135 and 59.137, caused the state to lose $10 million on investments. The state alleged that the Marsh shares were traded on an efficient securities market (the New York Stock Exchange), that the prices of the Marsh shares during the time at issue reflected the material information that Marsh disclosed to the market, and that the prices of the Marsh shares were artificially inflated because of Marsh's misrepresentations. The state also alleged that Marsh's alleged misrepresentations were brought to light through an investigation by the New York Attorney General, and once the misrepresentations were disclosed, the price of Marsh stock declined 37 percent, causing the state to lose approximately $10 million.

The trial court determined, and the Oregon Court of Appeals affirmed, that Or. Rev. Stat. §§ 59.135 and 59.137 require proof of reliance, the state had not established proof of actual reliance and the state could not establish reliance based on the fraud-on-the-market presumption. The Supreme Court of Oregon determined that the U.S. Supreme Court's consistent line of decisions reaffirming the fraud-on-the-market doctrine numerous times was compelling. The Supreme Court of Oregon reasoned that Or. Rev. Stat. § 59.137 was intended to create consistency between Oregon and federal securities laws and was enacted by the Oregon Legislative Assembly after the fraud-on-the-market doctrine had been a part of the federal law landscape for 15 years. Thus, the Oregon Legislative Assembly intended that reliance could be established through the use of the fraud-on-the-market presumption.

FOREIGN CORPORATIONS

SDNY Dismisses Claims Arising From Purchase of Stock on Indian Exchanges Under *Morrison*

***In re Satyam Computer Servs. Ltd. Sec. Litig.*, No. 09 MD 2027 (BSJ), 2013 WL 28053 (S.D.N.Y. Jan. 2, 2013)**

Judge Barbara S. Jones of the U.S. District Court for the Southern District of New York dismissed claims that certain Satyam Computer Services directors and officers violated section 10(b) of the Securities Exchange Act and sections 11 and 12(a)(2) of the Securities Act by allegedly overstating the income and assets of the company and borrowing heavily against the company's allegedly inflated stock. The court dismissed claims arising from the purchase of Satyam stock on Indian exchanges under *Morrison v. National Australian Bank Ltd.*, 130 S. Ct. 2869 (2010), because the transactions did not occur in the United States. The court also dismissed claims arising from alleged misrepresentations in SEC filings because the directors' failure to notice several purported signs of ongoing fraud were not enough to show scienter. In addition, the court dismissed claims against two companies operated by Satyam insiders because the plaintiffs failed to show sufficient connection between the defendants and transactions occurring in the U.S. to satisfy personal jurisdiction in U.S. courts, even though the insiders were involved in the fraud in India.

FORWARD-LOOKING STATEMENTS

SDNY Dismisses Claims Related to Allegedly Overly Optimistic Revenue Forecasts Issued by WebMD

***In re WebMD Health Corp. Sec. Litig.*, No. 11 Civ. 5382 (JFK), 2013 WL 64511 (S.D.N.Y. Jan. 2, 2013)**

Judge John F. Keenan of the U.S. District Court for the Southern District of New York dismissed claims that WebMD violated section 10(b) of the Securities Exchange Act by issuing allegedly overly optimistic revenue forecasts, even though it allegedly knew of adverse business developments relating to WebMD and the pharmaceutical industry as a whole. The court determined that the challenged statements were forward looking and subject to the Private Securities Litigation Reform Act's safe harbor provisions because those statements were accompanied by meaningful cautionary language and the plaintiffs failed to show that WebMD actually knew the statements were false. In addition, the complaint did not adequately allege that the challenged statements that were not forward looking were false or misleading. Further, even if the safe harbor provisions did not apply, the plaintiffs failed to adequately allege materiality and scienter.

INSIDER TRADING CLAIMS

Second Circuit Finds Section 16(b) Does Not Apply to Purchase of One Series of Stock and Sale of Another Series That Could Not Be Converted Into the First

***Gibbons v. Malone*, 703 F.3d 595 (2d. Cir. 2013)**

The U.S. Court of Appeals for the Second Circuit affirmed dismissal of an action brought under section 16(b) of the Securities Exchange Act because its limitations on short-term trading do not apply to the purchase of one series of a stock and the sale of another series that could not be converted into the first. The district court dismissed a claim for disgorgement against a company insider after he purchased Series A company stock and sold Series B company stock within a six-month period. Because the Series A and B company stock were separately traded and nonconvertible, the stocks were not the same for section 16(b) purposes. The court also declined to extend section 16(b) to stocks that are "substantially similar," finding that such a standard departs from the language of the statute and would be unworkable.

INVESTMENT COMPANY ACT

New Jersey Court Upholds Claims That Investment Manager Violated Fiduciary Duty with High Fees

***Kasilag v. Hartford Inv. Fin. Servs., LLC*, No. 11-1083, 2012 WL 6568476 (D.N.J. Dec. 17, 2012)**

In an opinion labeled "Not for Publication," Judge Renee Marie Bumb of the U.S. District Court for the District of New Jersey upheld claims that an investment manager violated section 36(b) of the Investment Company Act, but dismissed claims alleging that an investment manager violated SEC Rule 12b-1. As to the section 36(b) claims, the complaint adequately alleged that the investment manager violated its fiduciary duty by charging investment management fees significantly higher than the fees it paid to sub-advisers for similar work and the fees charged by one of its competitors. However, the court dismissed claims alleging that the defendant's distribution fees were excessively high under Rule 12b-1, even though they were charged in addition to "front-end sales" fees, because charging both fees is customary and the plaintiff failed to cite authority to the contrary.

LOSS CAUSATION

Second Circuit Affirms Dismissal of Claims That Citigroup Allegedly Made Misleading Statements About Its Capitalization and Liquidity During the 2008 Financial Crisis

***Solow v. Citigroup, Inc.*, No. 12-2499-cv, 2013 WL 149902 (2d Cir. Jan. 15, 2013)**

In a summary order, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of claims that Citigroup violated section 10(b) of the Securities Exchange Act by allegedly making misleading statements about its capitalization and liquidity during the 2008 financial crisis. Citigroup's statements that it was "well capitalized" were not misleading because they tracked the regulatory definition of that phrase, and it had no duty to disclose actions that only had the potential to negatively affect capitalization in the future. Further, the plaintiff failed to sufficiently allege loss causation as to Citigroup's statements about liquidity. The plaintiff failed to adequately allege that the statements were, in fact, disclosures of a previously concealed risk, and were responsible for the decreases in price (rather than general market conditions), even though the price of Citigroup's stock declined after the alleged corrective statements were made.

MATERIALITY

Sixth Circuit Affirms Summary Judgment, Holding That Closely Held Corporation's Failure to Disclose Merger Discussions During Stock Buyback Was Not Material

***Filing v. Phipps*, No. 11-4157, 2012 WL 5200375 (6th Cir. Oct. 23, 2012)**

In an unpublished opinion, the U.S. Court of Appeals for the Sixth Circuit affirmed a grant of summary judgment for the defendants, fiduciaries of White Rubber Company, holding that the closely held corporation's failure to disclose merger discussions during a stock buyback was not material under section 10(b) of the Securities Exchange Act. Although White Rubber Company initiated the buyback the month before the discussions began, the transaction did not occur until two years after the buyback. Moreover, in contrast to cases in which courts declined to hold that merger discussions were not material—*e.g.*, *Basic Inc. v. Levinson*, 485 U.S. 224 (1988)—during the period in question, White Rubber had not hired consultants to examine the transaction. Finally, although the representatives of the constituent corporations had discussed a merger, at the time of the stock buyback, these conversations were merely "preliminary." By contrast, the negotiations in cases like *Basic* involved the exchange of "vastly more confidential information."

SCIENTER

Ninth Circuit Reviews a Class Action Plaintiff's Allegations Holistically to Determine Whether Plaintiff Sufficiently Pled Scienter

***In re VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694 (9th Cir. 2012)**

The U.S. Court of Appeals for the Ninth Circuit held that while any one allegation may not compel an inference of scienter when viewed in isolation, when considered holistically "the inference [that defendants] were deliberately reckless as to the truth of their financial reports and related public statements is at least as compelling as any opposing inference" and thus sufficient to plead scienter.

The plaintiff, individually and on behalf of investors who purchased VeriFone Holdings, Inc. stock between August 31, 2006, and April 1, 2008, alleged that VeriFone, the company's CEO and former chairman, and the company's former CFO violated sections 10(b), 20(a) and 20A of the Securities Exchange Act in connection with a December 2007 restatement of financial results. In November 2006, VeriFone acquired Lipman Electronic Engineering Ltd. and began integrating the two companies. VeriFone publicized that the merger was likely to improve its financial condition, increasing its pro forma gross margin expectations from 41-44 percent to 42-47 percent. The plaintiff alleged, however, that the defendants were aware that VeriFone's own gross margins never exceeded 45.6 percent in the five prior quarters and Lipman's had just dropped to 41.9 percent after five years of declines, and thus a representation of increasing gross margins up to 48 percent during the class period had no reasonable basis.

In the three quarters following the merger, VeriFone reported gross margins of 47.1 percent, 48.1 percent and 48.2 percent, so that the company could claim the merger was a success. On December 3, 2007, VeriFone announced that its consolidated financial statements for those three quarters should not be relied upon due to errors in accounting, and the gross margins were accordingly reduced to 41.4 percent, 42.3 percent and 41.2 percent respectively. On the day of the statement, VeriFone shares fell from $48.03 to $26.03, dropping more than 45 percent.

The district court dismissed the third amended complaint for failure to plead a strong inference of scienter with respect to any of the defendants, and the Ninth Circuit reversed in part and affirmed in part. The Ninth Circuit recognized that the Supreme Court in *Matrixx* did not mandate a specific approach to reviewing the allegations of scienter. Thus, according to the court, some courts first discuss the sufficiency of specific allegations and then conduct a holistic review, as the district court did here, while others only conduct a holistic analysis. The Ninth Circuit, in approaching the case through a holistic review only, clarified that the district court did not err as a matter of law by first engaging in an individualized discussion of each of the allegations, but instead erred in its undue discounting of the claims as a whole and the conclusion that an inference of deliberate recklessness was not warranted under a holistic review.

The Ninth Circuit held that the plaintiff's allegations, reviewed together, gave rise to a strong, cogent inference that VeriFone and the individual defendants were deliberately reckless as to the truth or falsity of their statements regarding VeriFone's financial results, an inference equally as compelling as the competing inference that VeriFone "was simply overwhelmed with integrating a large new division into its existing business," as defendants contended. In so holding, the Ninth Circuit concluded, "[a]lthough [the defendants] attack individual allegations in isolation, they cannot overcome the overwhelming inference drawn from a holistic view."

SDNY Dismisses Claims Regarding Auditor's Issuance of Allegedly Deficient Audit Opinions for Investment Company That Purportedly Was Part of a Ponzi Scheme

***Iowa Pub. Emp.'s Ret. Sys. v. Deloitte & Touche LLP*, No. 12 Civ. 2136, 2013 WL 245805 (S.D.N.Y. Jan. 23, 2013)**

Judge J. Paul Oetken of the U.S. District Court for the Southern District of New York dismissed claims that an auditor violated section 10(b) of the Securities Exchange Act by issuing allegedly deficient audit opinions for an investment company that allegedly was part of a Ponzi scheme. The plaintiff did not adequately allege that the auditor failed to recognize "red flags" in the suspicious movement of money between company and employee accounts because it did not allege that the auditor actually had access to the transfer records or that the auditor failed to take particular steps to identify the fraud. Further, evidence that the SEC discovered the fraud independently was not enough to show recklessness because the SEC's investigation included multiple entities involved in the scheme.

Tennessee Court Dismisses Securities Fraud Class Action Where Statements Regarding Clinical Trial Did Not Support Inference of Scienter

***Sarafin v. BioMimetic Therapeutics, Inc.*, No. 3:11-0653, 2013 WL 139521 (M.D. Tenn. Jan. 10, 2013)**

Judge Kevin H. Sharp of the U.S. District Court for the Middle District of Tennessee dismissed a purported class action alleging that BioMimetic Therapeutics, Inc. violated section 10(b) of the Securities Exchange Act by allegedly hiding information about the integrity and statistically insignificant results of a clinical trial for a recombinant bone and tissue growth factor technology. The plaintiffs alleged that the company told the public it was using a primary study population approved by the Food and Drug Administration but then secretly switched the group. The switch in the population skewed the clinical trial results, making the results more favorable than they would have been under the originally proposed protocol. When the FDA's Orthopedic and Rehabilitation Devices Panel issued a report citing concerns about the trial, the stock price dropped.

The court found that, under the PSLRA's heightened pleading requirements, the investors failed to adequately support their claims with allegations of scienter. The company's press releases and earnings calls did not suggest a deliberate intention to deceive investors because the company had disclosed the existence of the two study groups and made statements about positive results based on the FDA-approved group. Even though the company made a pitch for why it believed the second population study was more accurate, the company acknowledged that the FDA would be looking at everything, including the primary study population. Further, the court found that the company did not commit fraud by making forward-looking statements about its earning potential or the FDA approval of the bone treatment, as the statements were protected by the PSLRA's safe harbor provisions.

SECONDARY ACTOR LIABILITY

Pennsylvania Court Grants Summary Judgment in Favor of Law Firm on Claims Related to Allegedly Fraudulent Financial Disclosures

***In re DVI Inc. Sec. Litig.*, No. 03-5336, 2013 WL 56071 (E.D. Pa. Jan. 4, 2013)**

Judge Legrome D. Davis of the U.S. District Court for the Eastern District of Pennsylvania granted summary judgment in favor of law firm Clifford Chance on claims that it violated section 10(b) of the Securities Exchange Act by allegedly drafting fraudulent financial disclosures in an attempt to hide certain financial information about the client's financial condition from investors and the SEC. The court held that the plaintiffs failed to show reliance because Clifford Chance owed no duty to investors to make, and did not make, any public statements regarding its client on which plaintiffs could have relied. In addition, Clifford Chance was not liable, despite playing a substantial role in the creation of public statements made by its client, because liability cannot be based solely on an advisory relationship under *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), and none of its client's public statements were publicly attributed to Clifford Chance.

SDNY Finds That Oppenheimer Acquisition Corp. Was Not Liable for Alleged Securities Law Violations of Wholly Owned Subsidiary

***Meridian Horizon Fund, LP v. Tremont Grp. Holdings, Inc.*, 747 F. Supp. 2d 406 (S.D.N.Y. 2012)**

Judge Thomas P. Griesa of the U.S. District Court for the Southern District of New York dismissed claims that Oppenheimer Acquisition Corp. was subject to control person liability under section 20(a) of the Securities Exchange Act for the alleged securities law violations of its wholly owned subsidiary because the complaint did not plead any culpable participation by Oppenheimer. On an issue that has divided the Southern District of New York, the court held that section 20(a) requires plaintiffs to show that a control person was in some meaningful sense a culpable participant in the primary violation. The court found that the weight of Second Circuit precedent required dismissal because the complaint failed to allege culpable participation on the part of Oppenheimer.

SECURITIES ACT CLAIMS

Second Circuit Reverses Dismissal of Suit Alleging Misrepresentations Concerning Underwriting Standards Applied to Home Loans Underlying Mortgage-Backed Securities

***N.J. Carpenters Health Fund v. Royal Bank of Scotland Grp., PLC*, 709 F.3d 109 (2d Cir. 2013)**

The U.S. Court of Appeals for the Second Circuit reversed the dismissal of claims alleging violations of sections 11 and 12(a)(2) of the Securities Act. RBS was sued for alleged misrepresentations concerning the underwriting standards applied to home loans underlying certain mortgage-backed securities. The panel held that, at this early stage of the proceedings, and crediting recollections attributed to certain former employees regarding purported systematic disregard for the stated underwriting standards, the plaintiffs raised a possible inference that the company misrepresented its underwriting standards by alleging that (i) a disproportionate number of the home loans included in the securities ultimately defaulted, and (ii) a rating agency downgraded the securities because of the bank's lax underwriting standards. The nationwide housing market collapse—a risk disclosed in the registration statement—did not constitute an "obvious alternative explanation" for the high default rate. Further, the alleged misrepresentations were material because a reasonable investor would want to know whether the company complied with its reported underwriting standards, and the company's general disclosure of the risks in the housing market would not necessarily alert investors to the company's alleged abandonment of the underwriting standards. (The court also vacated and remanded the district court's determination that the plaintiffs lacked class-standing in light of *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145 (2d Cir. 2012)).

First Circuit Reverses Dismissal of Claims Related to Pharmaceutical Company's Alleged Failure to Disclose Reports of More Than 20 Serious Adverse Events With Drug

***Silverstrand Invs. v. AMAG Pharm., Inc.*, 707 F.3d 95 (1st Cir. 2013)**

The U.S. Court of Appeals for the First Circuit reversed the dismissal of claims that AMAG Pharmaceuticals violated sections 11 and 12 of the Securities Act by allegedly failing to disclose in securities offering documents that AMAG had reported to the FDA that at least 23 serious adverse events had been reported to the FDA in connection with AMAG's Feraheme drug. The court determined that the complaint's allegations about AMAG's alleged omission of the serious adverse events in its offering documents plausibly pled a violation of Items 303 and 503 of Regulation S-K. Items 303 and 503 require a company to disclose known uncertainties that are reasonably likely to have material effects on the company and the most significant factors that may adversely affect the company, respectively—including that, in AMAG's case, Feraheme (i) had been on the market for six months, (ii) was approved on the third attempt (the FDA had twice declined to approve it due to safety concerns), (iii) was sold in a market dominated by alternatives with proven safety records, and (iv) was the entire basis for AMAG's profitability. However, the court upheld the dismissal of sections 11 and 12 claims premised on AMAG's alleged failure to disclose that a material portion of revenue was derived from Internet practices highlighted in an FDA warning letter issued nine months after the offering, because the complaint did not plead that AMAG derived a significant amount of revenue from Internet sales at the time of the securities offering.

SLUSA PRECLUSION

Ninth Circuit Revives Breach of Contract and Fiduciary Duty Claims Related to Variable Universal Life Insurance Contracts

***Freeman Invs., L.P. v. Pacific Life Ins. Co.*, 704 F.3d 1110 (9th Cir. 2013)**

The U.S. Court of Appeals for the Ninth Circuit revived plaintiffs' breach of contract and breach of the duty of good faith and fair dealing claims, previously dismissed by the district court, holding that the claims are not precluded by SLUSA. The plaintiffs, individuals who purchased variable life insurance policies from defendant Pacific Life Insurance Company, brought a putative class action against the defendant alleging breach of contract, breach of the duty of good faith and fair dealing, and unfair competition under Cal. Bus. & Prof. Code § 17200. The plaintiffs also claimed the statute of limitations should toll because the defendant concealed the actions giving rise to the plaintiffs' claims. The defendant moved to dismiss the complaint, arguing that the class action was precluded by SLUSA, which bars class actions brought under state law, whether styled in tort, contract or breach of fiduciary duty, that in essence claim misrepresentation or omission in connection with certain securities transactions. The district court granted the defendants' motion to dismiss in its entirety.

On appeal, the Ninth Circuit reasoned the plaintiffs need not show that the defendant fraudulently misrepresented the cost of insurance or omitted critical details in order to prevail on the breach claims; they need only persuade the court that theirs is the better reading of the contract. The Ninth Circuit further determined that the plaintiffs did not make a stealth allegation of fraudulent omission with their tolling argument, and the allegation that the defendant hid its breach of contract did not turn the breach claims into claims of fraudulent omission. The Ninth Circuit held the breach of contract and breach of the duty of good faith and fair dealing claims were not precluded by SLUSA and directed the district court to grant the plaintiffs leave to amend their complaint to eliminate references to hidden loads, knowing concealment and wrongful conduct, as these concepts were irrelevant to the plaintiffs' breach claims and tolling claims. The Ninth Circuit concluded the district court correctly dismissed the plaintiffs' unfair competition claim, as that claim was precluded by SLUSA.

STANDING

Ninth Circuit Requires Aftermarket Plaintiffs Adequately Allege That Shares Are Traceable to Stock Offering Made in Connection With the False or Misleading Statement

***In re Century Aluminum Co. Sec. Litig.*, 704 F.3d 1119 (9th Cir. 2013)**

The U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of plaintiffs' claims under section 11 of the Securities Act for lack of statutory standing, strictly applying the pleading requirements set forth in *Iqbal* and *Twombly* and holding that aftermarket plaintiffs must allege specific facts sufficient for a court to reasonably infer that their shares can be traced back to the relevant offering. The plaintiffs purchased aftermarket shares in defendant Century Aluminum Company at the end of January 2009. In their section 11 claims, the plaintiffs alleged the shares they purchased were issued under a materially false and misleading prospectus supplement, dated January 28, 2009, issued in connection with a secondary offering of 24.5 million shares of the company's stock. When the secondary offering commenced, more than 49 million shares of the company's common stock were already in the market.

The plaintiffs argued it was enough for them to allege that they "purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering" in order to establish standing. The Ninth Circuit, however, disagreed and determined that under the pleading requirements established in *Iqbal* and *Twombly*, plaintiffs must allege "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Specifically, the Ninth Circuit found that when a company has issued shares in multiple offerings, a greater level of factual specificity is needed before a court can reasonably infer that shares purchased in the aftermarket are traceable to a particular offering and particular allegedly false or misleading statements. The Ninth Circuit held that the plaintiffs' conclusory allegation that they "purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering" was devoid of factual content and fell short of what *Iqbal* and *Twombly* require in order to establish statutory standing under section 11 of the Securities Act.

SDNY Denies State Attorney General's Motion to Intervene in Proposed Class Action Settlement

***In re Am. Int'l. Grp., Inc. Sec. Litig.*, 689 F.3d 229 (S.D.N.Y. 2013)**

Judge Deborah A. Batts of the U.S. District Court for the Southern District of New York denied the New York Attorney General's motion to intervene in a proposed class action settlement of alleged violations of the Securities Exchange Act, because the New York Attorney General lacked standing. The New York Attorney General, which is pursuing a parallel state action against the defendants, objected to the proposed settlement because purported errors in an expert's testimony regarding loss causation allegedly undervalued damages in the case. But the court held that the New York Attorney General did not have standing to object under Rule 23 because it was not a class member, and similarly did not have standing under CAFA because the suit was filed before CAFA was enacted and does not give a state attorney general standing to intervene in any suit where state residents are members of a settling class. The court also rejected standing based on the New York Attorney General's claim that the proposed settlement would cause actual, imminent injury to the ongoing state case. Finally, the New York Attorney General's motion to intervene under Rule 24 was denied because the Attorney General failed to show a sufficient legal interest at stake to intervene as of right and intervention would unduly delay the action.

Mad Dogs and Englishmen[1]

By C. Evan Stewart

It is widely believed that George Bernard Shaw once observed that "[t]he United States and Great Britain are two countries separated by a common language."[2] A recent professional experience has brought home that sentiment more directly than I had previously understood. Sent around the world to help prepare critical witnesses for cross-examination on an important matter, I arrived to find that *none* of the witnesses had any cross-examination preparation. Why? Because under the ethical rules governing English lawyers, those lawyers could not "prepare" the witnesses for their upcoming experience. That was news to me (and the client).

When in Britain, Do as the Brits…

Under the applicable ethics rule in England, "[a] barrister must not rehearse, practice or coach a witness in relation to his evidence."[3] This principle applies equally to solicitors.[4] Two leading English cases—*R. v. Momodou and Limani*[5] and *Ultraframe (UK) Ltd. v. Fielding & Others*[6]—have given guidance as to what this rule means:

- "There is a dramatic difference between witness training or coaching, and witness familiarization. Training or coaching for witnesses…is not permitted.… The witness should give his or her own evidence, so far as practicable uninfluenced by what anyone else has said, whether in formal discussions or informal conversations. The rule reduces, indeed hopefully avoids any possibility, that one witness may tailor his evidence in light of what anyone else said, and equally, avoids any unfounded perception that he may have done so. These risks are inherent in witness training."
- It is permissible "to familiarize the witness with the layout of the court, the likely sequence of events when the witness is giving evidence, and a balanced appraisal of the different responsibilities of the various participants.… [But] none of this… involves discussion about proposed or intended evidence."[7]

The General Council of the Bar in England has "fleshed out" those judicial teachings, just a tad:

- "[I]t is…appropriate, as part of a witness familiarisation process, for barristers to advise witnesses as to the basic requirements for giving evidence, e.g., the need to listen to and answer questions put, to speak clearly and slowly…and to avoid irrelevant comments."[8]
- "In any discussions with witnesses regarding the process of giving evidence, great care must be taken not to do or say anything which could be interpreted as suggesting what the witness should say, or how he or she should express himself or herself in the witness box—that would be coaching."[9]

The Grand Council of the Bar has also published an additional piece of guidance:

- "[M]ock cross-examinations or rehearsals of particular lines of questioning that Counsel proposes to follow are not permitted.…[A Barrister's] duty is to extract the facts from the witness, not to pour them into him; to learn what the witness does not know, not to teach him what he ought to know."[10]

And in another publication, The Grand Council of the Bar—with typical English understatement—has highlighted the dangers of violating the no-coaching rule: such a violation "may place a barrister in a position of professional embarrassment…."[11]

In the Uncivilized Colonies, on the Other Hand…

The U.S. Supreme Court has made it clear that lawyers may not *improperly* influence a witness's testimony,[12] but the Court left what that means up to the ethics rules we lawyers write to enforce our own conduct. ABA Model Rule 3.3 bars a lawyer from knowingly offering false testimony; ABA Model Rule 3.4(b) mandates that a lawyer not "falsify evidence [or] counsel or assist a witness to testify falsely…."[13]

Subject to those broad proscriptions, any American trial lawyer worth his or her salt would believe it would be malpractice not to "horse shed" a witness prior to his or her testimony.[14] And while some legal academics may think this is a "dirty little secret,"[15] I distinctly remember my "Trial Techniques" course in 1976, taught by the legendary Irving Younger, in which he openly (and proudly) taught his eager students the ins and outs of how to "horse shed" a witness. And my subsequent tutelage as a young lawyer in private practice—under some of the finest trial lawyers in America—only reinforced and bolstered the teachings of Professor Younger.

It is, of course, easy to find examples where lawyers in preparing witnesses have pushed well over the ethics line—essentially suborning perjury (or worse).[16] Putting that to one side, however, can there be any serious argument—at least by and among American lawyers—that zealous advocacy permits trial lawyers to "horse shed" in (at least) the following ways?: (i) familiarizing a witness with documents he or she will likely be questioned about;[17] (ii) explaining to a witness the nature of the case, where he or she fits in, and what themes you want to develop through his or her testimony;[18] (iii) taking a witness through both a mock direct examination and a mock cross-examination; (iv) explaining that, especially on cross-examination, most questions can be answered "yes," "no," "I do not know," and "I do not recall" (the converse of this is to not volunteer information not responsive to a specific question); (v) explaining to a witness the importance of limiting his or her testimony to first-hand, personal knowledge (the obverse of this is to not guess or make assumptions); (vi) explaining to a witness, especially on cross-examination, the importance of listening to each word in a question and not passively accepting the accuracy of the questioner's presumed facts; (vii) explaining to a witness the importance of going slowly (the obverse of this is not to get into a rhythm with the questioner); (viii) giving the witness some tips on how to handle opposing counsel (e.g., be polite); (ix) explaining how to react if the opposing lawyers get into a tussle over a question; and (x) explaining to a witness the importance of telling the truth (and giving some body language tips to make it seem like that is what is actually taking place).[19]

The above items, to me at least, seem like Mom, apple pie, and the Flag. But, at the same time, they are obviously not Mum, fish and chips, and the Union Jack.[20] Oh well, as they say in Paris: "à chacun son goût."

While We Are at It…

There is another area in which the two jurisdictions' laws governing lawyers differ—big time—and it deserves a quick mention. Who should own a law firm? In England (and Australia), non-lawyers may invest in, own, and / or control law firms. In America, that (at least for now) cannot be the case.

This "brave new world" all got its start when an Australian personal injury law firm, Slater & Gordon, became the first law firm to invite capital infusions from non-lawyers. Listed on the Australian Stock Exchange in May 2007, Slater & Gordon has since more than tripled its revenues, added 30 offices (it now has 50), and has more than doubled its employees to circa 1,000. In 2011, England followed suit with the Legal Services Act, allowing for British firms to solicit investment by outsiders.[21]

Spurred by the Australian / British foray into this new business model, as well as by the fact that the District of Columbia Bar has allowed non-lawyers who work at law firms (e.g., lobbyists) to have an equity stake in firms within the District since the 1980s,[22] the ABA's 20-20 Ethics Commission considered, but then dropped (in 2012), a notion akin to the DC rule: to allow non-lawyers who work at law firms to own as much as 25% of the firm.[23]

Wholly independent of the ABA's consideration of its proposal, the Jacoby & Meyers law firm decided to litigate the broader issue: it challenged on constitutional grounds the ethical restrictions barring outside investors from taking equity positions in law firms. Initially, the lawsuit was dismissed by Judge Kaplan in the Southern District of New York because, even if New York's applicable ethical rule (Rule 5.4(d)(1)) were to be struck down (Judge Kaplan ruled that Jacoby & Meyers had not shown it had suffered actual harm from the rule), two statutory provisions (New York Judiciary Law § 495 and New York Limited Liability Company Law § 201) independently bar outside, non-lawyer investment in law firms; on November 21, 2012, the Second Circuit vacated the decision, remanded the case to Judge Kaplan, and allowed Jacoby & Meyers to challenge the New York statutes on the same basis.[24]

When (and how) the Jacoby & Meyers case will ultimately turn out is anyone's guess. But even if it turns out in favor of the law firm, will it really change things in America? One man's view (mine) is no. Why? Because lawyers and law firms are, and will still be, governed by Rule 5.6. That rule is a very explicit bar against lawyer non-competition restrictions (except with respect to retirement benefits). Unlike in Australia and England (and unlike for every other profession in this country), we American lawyers have carved out for ourselves a rule that noncompetition restrictions will not apply to the legal profession.[25] And so long as a lawyer (or a group of lawyers) is free to move from law firm A to law firm B with impunity, why would Ron Perelman or Carl Icahn invest $100 million in law firm A on day one, knowing that they could leave for law firm B on day two? That is a rhetorical question.

Conclusion

Even though many of the traditions of the American legal system have been handed down or derived from jolly old England, we must face the fact that we are two similar, yet different, systems.[26] That fact is certainly brought home most starkly on the witness preparation front. It gives me another reason to be proud to be an American!

Endnotes

1. "Mad Dogs and Englishmen" is a song Noel Coward wrote and was first performed by Beatrice Lillie in The Third Little Show on June 1, 1931 at the Music Box Theatre in New York City ("Mad Dogs and Englishmen go out in the midday sun."). Thirty-nine years later, Joe Cocker appropriated the title for his live album of songs recorded at the Fillmore East in New York City on March 27–28, 1970.
2. From my research, however, original authorship cannot definitively be given to Shaw. Oscar Wilde, however, did once write: "We have really everything in common with America nowadays, except, of course, language." Oscar Wilde, The Canterville Ghost (1887).
3. Code of Conduct § 705(a). The Code of Conduct is promulgated by the General Council of the Bar.
4. The Law Society's Code for Advocacy § 6.5(b). The Law Society's Code is promulgated by The Law Society of England and Wales.
5. R. v. Momodou, [2005] EWCA (Crim) 177.
6. Ultraframe (UK) Ltd. v. Fielding & Others, [2005] EWHC (Ch) 1638.
7. *See Momodou*, [2005] EWCA (Crim) 177, at ¶¶ 61–62.
8. *Guidance on Witness Preparation*, Bar Standards Board § 5, *available at* https://www.barstandardsboard.org.uk/code-guidance/guidance-on-witness-preparation/ (last updated Sept. 2008).
9. *Id.* § 12(2).

10. Guidance on Preparation of Witness Statements—Preparing Witness Statements for Use in Civil Proceedings Dealing with Witnesses, Bar Standards Board, *available at* https://www.barstandardsboard.org.uk/code-guidance/preparing-witness-statements-for-use-in-civil-proceedings/ (last updated Sept. 2008).

11. Written Standards for the Conduct of Professional Work, Bar Standards Board § 6.2.4, *available at* https://www.barstandardsboard.org.uk/regulatory-requirements/the-code-of-conduct/written-standards-for-the-conduct-of-professional-work/ (last visited Apr. 7, 2013). For a more learned discussion of the English system on this score, see M. Hall, *Rules of Conduct for Counsel and Judges: A Panel Discussion on English and American Practices*, 7 Geo. J. Legal Ethics 865, 869 (1994). Many other countries (e.g., Germany, Belgium, Italy, France, Switzerland) follow the English system vis-à-vis witness preparation. See, e.g., W. Prizzi & W. Perron, *Crime Victims in German Courtrooms: A Comparative Perspective on American Problems*, 32 Stan. J. Int'l L. 37, 43 (1996).

12. Geders v. United States, 425 U.S. 80 (1976).

13. Model Rules of Prof'l Conduct R. 3.4 cmt. 1 tracks the Geders jurisprudence, prohibiting lawyers from "improperly influencing witnesses." See also Model Rules of Prof'l Conduct R. 3.4(a) ("[A lawyer shall not] unlawfully obstruct another party's access to evidence…."). See C. Evan Stewart, *Andersen: Reviewing Ethics for Document Shredding*, N.Y. L.J. (Apr. 15, 2002).

14. See James W. McElhaney, Trial Notebook 50 (3d ed. 1994) (citing the historical use of carriage houses behind the courthouse for pre-trial witness preparation). See also C. Evan Stewart, *Corporate Counsel and Attorney Work Product*, N.Y. L.J (Nov. 8, 1993).

15. See Roberta K. Flowers, *Witness Preparation: Regulating the Profession's "Dirty Little Secret,"* 38 Hastings Const. L. Q. 1007 (2011).

16. See J. Rogers, *Ethics of Witness Preparation*, ABA/BNA Lawyer's Manual on Prof'l Conduct (Feb. 18, 1998) (discussing how plaintiffs' law firm in asbestos litigation told its clients—in writing—that they should stress that they had "NO IDEA ASBESTOS WAS DANGEROUS," and that they "NEVER" saw any warnings of any kind). Besides suborning perjury, witness tampering is a federal offense, 18 U.S.C. §1512, as is giving "anything of value" to a person in connection with their testimony. 18 U.S.C. § 201 (2013).

17. Of course, lawyers must never forget that any written materials used to refresh a witness's memory (including attorney work product) is fair game under Fed. R. Evid. 612. See, e.g., Redvanly v. NYNEX Corp., 152 F.R.D. 460 (S.D.N.Y. 1993); Berkey Photo Inc. v. Eastman Kodak Co., 74 F.R.D. 613 (S.D.N.Y. 1977).

18. See *In re* Cendant Corp. Sec. Litig., 343 F.3d 658 (3d Cir. 2003).

19. By such preparation, is not a lawyer fulfilling his or her most basic obligation to the client, as specified in ABA Model Rule 1.1 (competence)?

20. This is not to suggest that the English ethics rules do not have a bite or that The Grand Council of the Bar does not enforce those rules. That said, however, by its own admission it needs to tighten things up a bit. See Russ Buettner, *Falling Far Short of the Whole Truth*, N.Y. Times, Feb. 14, 2013, at A21.

21. Afterward, a spate of applications was made to invest in British law firms. For example, Slater & Gordon bought Russell Jones & Walker for 54 million pounds, and a private equity firm, Duke Street, paid approximately 50 million pounds for a majority stake in Parabis Group.

22. See D.C. Rules of Prof'l Conduct R. 5.4(b) cmt. 8. The District of Columbia does not allow for non-lawyers, outside of the law firm, to have an ownership interest therein.

23. See J. Rogers, *Ethics 20/20 Ditches Idea of Recommending Option for Nonlawyer Owners in Law Firms*, ABA/BNA Lawyers' Manual on Professional Conduct 250 (Apr. 25, 2012). Shortly after the ABA's 20-20 Commission dropped its consideration of the 25% proposal, the New York State Bar formally issued a detailed report opposing non-lawyer ownership in law firms. See J. Rogers, *New York State Bar Reaffirms Opposition to Nonlawyer Ownership*, ABA/BNA Lawyers' Manual and Prof'l Conduct 747 (Dec. 5, 2012).

24. See *Second Circuit Revives Suit Challenging Ban on Nonlawyer Investment in Law Firms*, ABA/BNA Lawyers' Manual on Prof'l Conduct 732 (Dec. 5, 2012).

25. Unfortunately, my new favorite television show, "Suits," has gotten this wrong. The partners of Pearson Hardman are locked into the firm by restrictive covenants. I guess this also means that George Reeves really could not fly in "Superman"!

26. One area not touched on above is the fact that the legal profession is no longer self-regulated in England; rather, the government has taken on that job. On this side of the Atlantic we should resist being too smug on that score, however, given the Securities and Exchange Commission's attempt to pre-empt lawyer regulation, at least as to those who practice securities law. *See* C. Evan Stewart, *New York's New Ethics Rules: What You Don't Know Can Hurt You!*, N.Y. Bus. L. J. (Fall 2009).

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Affiliate, Affiliate, Who Exactly Is an Affiliate? Ensuring Director Independence for Executive Compensation Committees

By Emily Drazan

Pursuant to section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[1] the Securities and Exchange Commission ("SEC") adopted Rule 10C-1 on June 20, 2012.[2] Part of Rule 10C-1 required the national exchanges to issue listing standards to ensure the independence of executive compensation committees for listed companies. Under Rule 10C-1, the exchanges must require listed companies to consider relevant factors to determine director independence, including, but not limited to: (a) the source of compensation of the director, including any consulting, advisory or other compensatory fee paid by the issuer to the director, and (b) whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer, when forming a compensation committee.[3]

On January 11, 2013, the SEC approved the new listing standards for the New York Stock Exchange (the "NYSE") and the NASDAQ Stock Market ("NASDAQ").[4] The new listing standards, with respect to the independence of directors, become effective on July 1, 2013, and require listed companies to examine all relevant factors, including the two factors specifically enumerated in Rule 10C-1. The commentary to the new standards indicates that both the NYSE and NASDAQ are concerned over whether an affiliated director can make independent judgments about executive compensation, while acknowledging that in some situations affiliation may align with shareholder interests. Although the commentary does provide some guidance as to who qualifies as an affiliate, whether or not an individual is an "affiliate of the issuer" has challenged practitioners for nearly eighty years. This article will attempt to highlight some of the facts and circumstances which the SEC has used to determine whether an individual is an affiliate of the issuer, by piecing together cases and No-Action letters from the past eight decades.

Facts and Circumstances to Determine Affiliate Status

Rule 10C-1 and the commentary to the new listings standards appear to mirror the definition of affiliate found in Rule 405, which defines an affiliate as "a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified."[5] Determination of affiliate status hinges on the particular facts and circumstances which confer "control" on an individual.[6] Rule 405 defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and polices of a person, whether through the ownership of voting securities, by contract, or otherwise."[7] Affiliate status does not require an individual to "be an officer, director, manager, or even [a] shareholder to be a controlling person. Further, control may exist although not continuously and actively exercised."[8]

The definition in Rule 405 creates a rebuttable presumption of control if an individual is an officer, a board member, and / or an owner of at least 10% of outstanding voting stock. As noted above, however, there must be a review of the facts and circumstances in each particular case. Interestingly, both courts and the SEC have rarely found the existence of control on the basis of a single factor, and they base the determination on several factors that collectively indicate the power of the individual or group to direct the policies of the corporation.[9] Prior to joining the Commission, former SEC Commissioner Sommer described the determination of control as follows:

> While there is nothing in the statutes or the regulations or rulings by the Commission which says such a holder [(10% or more)] is *ipso facto* a controlling person, generally such degree of ownership should create caution and might be regarded as creating a rebuttable presumption of control, especially if such holdings are combined with executive office, membership on the board, or wide dispersion of the remainder of the stock.[10]

Below are some of the other characteristics issuers should be assessing when considering whether a director qualifies as an affiliate.

Membership on the Board of Directors

The SEC's interpretation has created a rebuttable presumption of affiliate status based on membership on the board of directors.[11] Courts have held that board membership alone is not enough, and determination should also be based on the duration of membership on the board and the individual's influence over other members of the board.[12]

Executive Officer of the Company

Similar to a position on the board of directors, an executive officer faces a rebuttable presumption of control. However, due to the fact that an executive officer is more likely to be participating in or controlling day-to-day activities of the company, there is a higher expectation of control status.[13]

Percentage of Outstanding Stock Ownership

Far less than majority ownership can result in control of a company, and it is not necessary that the shareholder(s) in question could win a proxy vote against management.[14] SEC No-Action letters have shown that share ownership just below 10% and above establishes a "significant proportion" of ownership denoting control.[15]

Membership in Controlling Group/Voting Agreements

Importantly, control may rest with more than one person at a time; a control group is composed of shareholders who individually do not qualify as an affiliate but who together have the power to influence management.[16] Shareholders can gain a controlling interest through trust, proxy, power of attorney, pooling agreements or any other contract that transfers voting or selling rights.[17]

Contractual Right to Designate Person on Board of Directors

As part of creditor or venture capital contracts an individual can be provided the opportunity to select members for the board of directors, and may provide influence or control over the selected member.[18]

Relationship with Management

An individual who owns a "significant proportion" of the outstanding company stock or who is a substantial customer may have a close personal or business relationship with a company which results in a position of control over the management.[19]

Individual Influence

An individual can have influence over a company's management and policies even if he or she does not hold a management or board position; control can be found when an individual affects essential programs and policies of the company.[20] Additionally, an individual may exercise control through influence through his or her reputation or relationship with other shareholders.[21]

Relative of an Affiliate

Individuals with familial relationships with an officer or director or an affiliate shareholder have been found to be affiliates under SEC No-Action Letters.[22]

Release from Affiliate Status

Notably, courts and the SEC have recognized that affiliate status is not retained forever: "once a control person does not mean always a control person."[23] However, certain conditions and criteria must change to remove the perception of control before an individual is released from affiliate status. An interpretive guidance issued by the SEC, regarding affiliate status under Rule 144, stated that the cessation of control depends on facts and circumstances particular to the case: one should not believe that control ceases immediately and should wait for a period of time before selling the non-restricted securities.[24]

Conclusion

Under the new listing standards issuers must examine a number of factors to ensure the independence of the members of executive compensation committees. Many situations may cause a director to be an affiliate of the issuer or to be affiliated with another affiliate of the issuer. Practitioners should examine the particular facts and circumstances of each potential committee member's relationship with the company. A rebuttable presumption of affiliate status is established under certain conditions, and the burden falls on the director to show that he or she is still able to exercise independent judgment regarding executive compensation.

Endnotes.

1. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat 1376 § 952, 15 U.S.C. § 78j-3 (2012).
2. *See* Listing Standards for Compensation Committees and Disclosure Regarding Compensation Consultant Conflicts of Interest, Securities Act Release No. 33-9330, Exchange Act Release No. 34-67220 (June 20, 2012), 77 Fed. Reg. 38,422 (proposed June 27, 2012).
3. *See* 15 U.S.C. § 78j-3(a)(3).
4. Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 3, and Order Granting Accelerated Approval for Proposed Rule Change, as Modified by Amendment Nos. 1 and 3, to Amend the Listing Rules for Compensation Committees to Comply with Securities Exchange Act Rule 10C-1 and Make Other Related Changes, Exchange Act Release No. 34-68639 (Jan. 11, 2013) (order approving the NYSE's proposed rule changes, as amended); Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment Nos. 1 and 2, and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment Nos. 1 and 2 to Amend the Listing Rules for Compensation Committees to Comply with Rule 10C-1 Under the Act and Make Other Related Changes, Exchange Act Release No. 34-68640 (Jan. 11, 2013) (approving Nasdaq's proposed rule changes, as amended).
5. 17 C.F.R. § 230.405 (2013).
6. *See* SEC v. Platform Wireless Int'l Corp., 617 F.3d 1072, 1087 (9th Cir. 2010).
7. 17 C.F.R. § 230.405.
8. Pennaluna & Co. v. SEC, 410 F.2d 861, 866 (9th Cir. 1969) (citations omitted).
9. *Compare* SEC v. Computronic Indus. Corp., 294 F. Supp. 1136, 1139 (N.D. Tex. 1968) (defining "control" to mean, at the very least, any officer or director); Dakota Minerals, Inc., SEC No-Action Letter, 1976 WL 11464, at *1 (July 29, 1976) (denying removal of restrictive legend because that investor's husband was the

secretary of the company), *with* SEC v. Nat'l Bankers Life Ins. Co., 334 F. Supp. 444, 455 (N.D. Tex. 1971) (finding defendants to be in a position to control or exercise control due to stock ownership, director positions, officer positions, family ties, creditor positions, and dominating persuasiveness); American-Standard, SEC No-Action Letter, 1972 WL 19628, at *4 (Oct. 11, 1972) (holding that an SEC determination of an individual's status as a control person is a factual question which must be answered by considering other relevant facts beyond status as officer, director or 10% shareholder).

10. A.A. Sommer, Jr., *Who's "In Control"?—S.E.C.*, 21 Bus. Law. 559, 568 (1966).
11. *See* American-Standard, SEC No-Action Letter, 1972 WL 19628, at *4 (Oct. 4, 1972) (discussing Rule 405's definition of "control" which acknowledges that power to direct management can derive from "ownership of voting securities, by contract, or otherwise").
12. *See* Wilko v. Swan, 127 F. Supp. 55 (S.D.N.Y. 1955) (denying director's motion to dismiss on other grounds, implying that the fact a person is a director of a corporation does not, as a matter of law, make the individual a controlling person under section 2(11)); *see generally* SEC v. Nat'l Bankers Life Ins. Co., 334 F. Supp. 444 (1973) (explaining that defendants who were directors also had strong influence over company activities).
13. *Computronic Indus. Corp.*, 294 F. Supp. at 1139 (explaining that the president controlled the corporation, thus those who purchased shares from him with intention to distribute were "underwriters"); Res. Corp. Int'l., Exchange Act Release No. 33-2294, 7 S.E.C. 689, at *18–19 (July 10, 1940) (discussing situation where executive officers had complete control of corporation absent the board of the directors, and the board of directors did not meet annually as required by the bylaws).
14. United States v. Wolfson, 405 F.2d 779, 781 (2d Cir. 1968); United States v. Crosby, 294 F.2d 928, 939–40 (2d Cir. 1961); Gratz v. Claughton, 187 F.2d 46, 49–50 (2d Cir. 1951); Chicago Corp., Exchange Act Release No. 40-1203, 28 S.E.C. 463, at *9–11 (Aug. 23, 1948).
15. *See* Servo Sys., Inc., SEC No-Action Letter, 1979 WL 14302, at *1 (Sept. 10, 1979) (concluding that former Vice President and Director of Servo with ownership of 14.6% of outstanding voting stock was an affiliate); Torr Lab., Inc., SEC No-Action Letter, 1975 WL 10493, at *1 (June 16, 1975) (concluding that former officer and director had a large percentage of shares and deemed him an affiliate when he owned 9.9% of outstanding voting stock); see *also* A.A. Sommer, Jr., *supra* note 10, at 569 (citing a Fortune Magazine article where 9.7% stock ownership resulted in effective control leading to management upheaval, recognition of the new shareholder's control, and election of officers to satisfy shareholder). *But cf.* Documentation, Inc., SEC No-Action Letter, 1976 WL 11349, at *1 (Oct. 13, 1976) (holding that former Senior Engineer with .15% of the company's outstanding voting stock was determined not to be an affiliate).
16. *Compare* United States v. Dardi, 330 F.2d 316, 325–26 (2d Cir. 1964); Pennaluna & Co. v. SEC, 410 F.2d 861, 866 (9th Cir. 1969), *with* SEC v. Am. Beryllium & Oil Corp., 303 F. Supp. 912, 915 (S.D.N.Y. 1969).
17. Ira Haupt & Co., Exchange Act Release No. 34-3845, 23 S.E.C. 589, at *6 (Aug. 20, 1946).
18. SEC v. Nat'l Bankers Life Ins. Co., 334 F. Supp. 444, 455 (1973).
19. *Pennaluna*, 410 F.2d at 866; *In re* Walston & Co., Exchange Act Release No.34-2603, 7 S.E.C. 937, at *9 (Aug. 2, 1940).
20. United States v. Corr, 543 F.2d 1042, 1050; SEC v. Cavanagh, 1 F. Supp. 2d 337 (S.D.N.Y. 1998); *Wolfson*, 405 F.2d at 781 (holding individual was the "guiding spirit" of the corporation and no corporate policy decisions were made without his consent, although he was not an officer or director).
21. *Pennaluna*, 410 F.2d at 866.
22. *See* Dakota Minerals Inc., SEC No-Action Letter, 1976 WL 1464, at *1 (July 29, 1976); Halbern Indus., Inc., SEC No-Action Letter, 1972 WL 7429, at *1 (Sept. 8, 1972); Fort Howard Paper Co., SEC No-Action Letter, 1975 WL 10413, at *2 (Nov. 20, 1975); Perini Corp., SEC No-Action Letter, 1972 WL 11257, at *2 (Oct. 23, 1972).
23. *See, e.g.*, WNH Invs., LLC v. Batzel, 1995 WL 262248, at *5 (Del. Ch. 1995).
24. SEC Staff Compliance and Disclosure Interpretations: Interpretative Responses Regarding Particular Situations, § 201.06 (Apr. 2, 2007), *available at* http://www.sec.gov/divisions/corpfin/guidance/rule144interp.htm.

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Committee Reports

From the Section Chair

It seems as though I was just beginning my term as Chair of the Business Law Section, and now in just a few weeks my term will be drawing to a close. How quickly the year has passed.

So far, 2013 has been a busy and successful year for the Section. At the Annual Meeting in New York in January, the Section presented a well-attended Continuing Legal Education ("CLE") program designed for small firm and general corporate practitioners. Topics included securities law for non-securities lawyers, employment law issues for small to mid-size companies and an update on recent ethics developments. The program was followed by a luncheon and afternoon meetings of our various committees, many of which provided additional CLE credits.

The Section was also pleased to sponsor the Young Lawyers' Section Trial Academy in March, providing scholarships for two attorneys to attend the program. We also provided sponsorship donations for the Monroe County Bar Association's Law Day diversity presentation and for Banking and Bankruptcy Programs to be held later this summer.

Our committees continued to provide valuable guidance to the State Bar on legislative initiatives relevant to the Section's members, such as proposed legislation relating to remote participation at corporate shareholder meetings and the proposed modernization of New York's Uniform Commercial Code.

On a sad note, the Section lost a valuable member and friend this year. David Caplan, a member of the Business Law Section Executive Committee and Chair of the Technology and Venture Law Committee, passed away unexpectedly in late January, shortly after the Annual Meeting. David was an active member of the Section, a regular speaker at Section programs, and a wonderful person. David will be greatly missed.

Looking ahead for the rest of 2013, the Section's Fall meeting will be held at the beautiful Cranwell Resort in the Berkshires from October 3–5. We look forward to seeing many of our members at the Cranwell this Fall. Also in the Fall, the Section will be partnering with Albany Law School to present what will hopefully become an annual Business Law Symposium to be held at the law school. We are excited about joining with Albany Law School in this venture.

It has been an honor to Chair the Business Law Section for the past ten months, and I look forward to continuing to work with the Section for many years to come.

Deborah A. Doxey, Esq., NYSBA BLS Chair

Banking Law Committee

With the never-ending barrage of new regulations, especially under Dodd-Frank, it has been a busy year for the Banking Law Committee. In 2012 we liaised with the Association of the Bar of the City of New York regarding that Association's efforts to (finally) bring New York, the presumptive leader in commercial law, into line with the other 49 states by adopting an omnibus package of amendments to the Uniform Commercial Code, many of which have been in place elsewhere for 20 years or more. These would include key amendments to Articles 3 and 4 of the UCC, which govern commercial paper and bank deposits and collections. A major sticking point for the New York legislature in the 1990s was the concept of check truncation, whereby banks are no longer required to return the paper checks to their customers, at best a costly and labor-intensive process. The concern: how can grandma prove that she paid the rent if she doesn't get her cancelled check back? That concern was effectively mooted by federal law, the Check 21 Act, in 2003, which allowed all banking institutions to effect truncation by providing a substitute check where required. The Committee members expressed support for the omnibus package and recommended to the Section Executive Committee that it do likewise.

In January, in conjunction with the NYSBA Annual Meeting, the Committee held a well-attended meeting at which our guest speakers were Richard Charlton, Counsel and Vice President of the Federal Reserve Bank of New York, and Roberta Kotkin, General Counsel and Chief Operating Officer of the New York Bankers Association. Mr. Charlton discussed the Federal Reserve's ongoing implementation of the Dodd-Frank Act through rule-making, highlighting the difficulties presented in adapting the Act's provisions to the many different types of banking institutions, ranging from small community banks to large foreign banks with U.S. operations. With respect to the latter, Mr. Charlton focused on the Federal Reserve's proposal to implement Dodd-Frank's mandate for heightened prudential standards by, among other things, requiring foreign banking organizations to establish well-capitalized intermediate holding companies in the U.S. to hold their U.S. subsidiaries. Ms. Kotkin reviewed the

NYBA's position on significant federal and state legislation and regulations affecting banks, and discussed the efforts of NYBA's member banks to assist in recovery from Superstorm Sandy—for example, by providing a means to expedite payment of insurance proceeds to homeowners where the bank's endorsement of the check is required because it holds the lien on the home.

Our May meeting featured Jeffrey Ingber, senior vice president in the Financial Institutions Group of the Federal Reserve Bank of New York. Mr. Ingber discussed the Fed's supervisory concerns regarding the foreign and large domestic institutions it oversees, noting that it was attempting to be more of a prudential regulator, rather than seeking to play "gotcha" in the bank examinations process. There was a lively and interactive discussion. Mr. Ingber pledged to line up a Fed colleague whose focus is more on community banks to speak at our next meeting. With regret, I relinquished the Chair's gavel as my second three-year term came to an end. The good news is that the Committee leadership is in good hands, as I will be succeeded by Kathleen Scott of Arnold & Porter, an experienced and knowledgeable banking lawyer.

David L. Glass, Esq., Chair

Bankruptcy Law Committee

The Bankruptcy Law Committee co-sponsored a program on Advising Distressed Businesses and Business Bankruptcy Cases held in Albany on November 14, 2012 and in New York City on December 13, 2012. The Committee also met at the Annual Meeting on January 23, 2013 at which Judge (and former Bankruptcy Committee Chair) Margaret Cangilos-Ruiz (N.D.N.Y.) presented a program entitled "Bankruptcy Court's Exercise of Judicial Power after *Stern v. Marshall*—'Narrow' Holding of Limited Scope or More Far Reaching Implications?"

Kevin Newman, Esq., Chair

Franchise, Distribution and Licensing Law Committee

The Franchise, Distribution and Licensing Law Committee has been very active this year. The Committee continues to pursue changes to the New York Franchise Sales Act and its accompanying Regulations in order to make the Act more business friendly and consistent with the Federal Franchise Rule, which was amended in 2008. The most recent Committee meeting was held on January 23, 2013. The meeting included a presentation by Aaron Chaitovsky, CPA, CFE and a Partner with the New York-based accounting firm, Citrin Cooperman. Mr. Chaitovsky's presentation included a discussion regarding counsel's obligation to review and understand the financial statements included in a franchisor's Franchise Disclosure Document. The session also included a review of the basis components of financial statements prepared in accordance with GAAP, a detailed examination of franchisor cash flow statements and an identification of the critical items typically included in a franchisor's financial statements which can reveal the financial viability of a franchisor. The next Committee meeting will take place in June 2013. Please contact committee Chair David W. Oppenheim (doppenheim@kaufmanngildin.com) for more information.

David W. Oppenheim, Esq., Chair

Securities Regulation Committee

The Securities Regulation Committee has continued its monthly meeting programs addressing a wide range of matters of importance to securities law practitioners. Our dinner meetings tend to foster lively discussions, and afford Committee members an opportunity to discuss "hot topics" with persons closely associated with them. Since our last Committee report in the Winter 2012 *Journal*, among the topics presented at meetings were:

1. How New European Union Regulations Impact U.S. Markets (market infrastructure regulations and short selling regulations)
2. Ethics and Managing a Corporate Crisis
3. ISS 2013 Proxy Voting Guidelines and Preparing for the Upcoming Proxy Season
4. Former SEC Commissioners Speak about the Past and Future of the SEC, plus More
5. Latest Developments in CFTC Regulation of Private Funds: Congratulations, you're a commodity pool operator—Now what?
6. PIPES, Hedging and SEC Enforcement
7. Cyber Attacks and Social Media
8. The Controversy Over Changes To 13D Beneficial Ownership Reporting
9. Decimalization: Is the Penny Tick Size Harming the U.S. Capital Markets?
10. Everything You Always Wanted to Know About Depositary Receipt Programs* (*But Were Afraid To Ask)

In addition, our Private Investment Funds Subcommittee held a meeting in December 2012, titled "U.S. Foreign Account Tax Compliance Act (FATCA): Meeting the New Deadlines." The Subcommittee closely tracks developments and emerging trends in the private investment funds industry.

For more information about, and how to join, the Securities Regulation Committee and Private Investment Funds Subcommittee, go to the website www.nysba.org/SecuritiesRegulation or www.nysba.org/PIF. We are also on LinkedIn at www.nysba.org/SecuritiesRegulationLinkedIn or www.nysba.org/PIFLinkedIn.

Howard Dicker, Esq., Chair

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All proposed articles should be submitted to the *Journal*'s Editor-in-Chief. Submissions should be e-mailed or sent on a disk or CD in electronic format, preferably Microsoft Word (pdfs are not acceptable). A short author's biography should also be included.

The editors reserve the right to edit the manuscript to have it conform to the *Journal*'s standard in style, usage and analysis. All citations will be confirmed. Authors should consult standard authorities in preparing both text and footnotes, and should consult and follow the style presented in *Bluebook: A Uniform System of Citation*. An *Author's Guide* can be obtained by contacting the Editor-in-Chief. The revised manuscript will be submitted to the author for approval prior to publication.

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NEW YORK STATE BAR ASSOCIATION

Business Law Section

ANNUAL STUDENT WRITING COMPETITION

The Business Law Section sponsors an annual Student Writing Competition, open to all students who are candidates for the J.D. or LL.M. degree at an accredited law school during the year in which the article is submitted. The student articles submitted in a given year that are judged first and second best, provided they are of publishable quality and otherwise meet the criteria of the Competition, will receive cash prizes of $1,500 and $1,000, respectively. At the discretion of the editors, they also will be published in the NYSBA *NY Business Law Journal*, which is sponsored by the Section in cooperation with New York Law School. Additional cash prizes may be awarded in the discretion of the Section. Entries that do not qualify for cash prizes may also be considered for publication in the *Journal*.

Articles submitted will be judged on the following criteria:

- Relevance to the *Journal*'s audience (New York business lawyers)
- Timeliness of the topic
- Originality
- Quality of research and writing
- Clarity and conciseness

The manuscript should follow Bluebook cite format (using endnotes rather than footnotes) and be a minimum of 3,000 words (there is no maximum). All submissions become the property of the NYSBA and the *NY Business Law Journal*. By submitting an article, the student is deemed to consent to its publication, whether or not a cash prize is awarded.

To enter, the student should submit an original, unpublished manuscript in Word format to David L. Glass, Editor-in-Chief, NYSBA *NY Business Law Journal* (david.glass@macquarie.com). The student should include a brief biography, including law school attended, degree for which the student is a candidate, and expected year of graduation.

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