January 2014

- **Our Mini-Theme: Social Media and Business Law – People Get Ready, There’s a Train a’comin’**
- **The Threat of Social Media Diligence on the Confidentiality of the M&A Process: The Problem and Possible Solutions**
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- **10 Tips for Avoiding Ethical Lapses When Using Social Media**
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- **Privacy and Social Media**
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- **Words that Matter: Considerations in Drafting Preferred Stock Provisions**
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Departments:

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  Canada’s new anti-spam laws (CASL) will come into force on July 1, 2014, and is the toughest anti-spam law in the world. Whether or not your client is not located in Canada, CASL may affect your client.
- **Delaware Insider: Inadvertently Waiving Right to Seek Judicial Dissolution of LLC: It is Easier to do than You Think**
  Opting out of all of the members’ default rights under the LLC Act waives the right to seek judicial dissolution, unless the LLC agreement specifically enumerates the right to seek judicial dissolution.
- **Ethics Corner: Losing the Privilege When the Subsidiary is Sold**
  Most of us don’t think much in advance about what happens when the parent-subsidiary relationship changes, but the consequences can be very significant.
- **Member Spotlight: Interview with Alvin W. Thompson**
  Before being appointed a U.S. District Judge for the District of Connecticut in 1994 by President Clinton, Alvin W. Thompson served for three years as the managing partner of Robinson & Cole, the first African-American to lead a large Connecticut law firm. A former chair of the Business Law Section (2005–2006), Thompson has worn many hats in the Section.

**Inside Business Law**

*The Business Law Section held its 2013 Fall Meeting on November 22 and 23 in Washington, D.C. The Meeting featured outstanding CLE programs, six of which we highlighted in December and six of which we highlight in this issue.*
The explosion of the use of social media has affected many aspects of our lives, and the relationship of social media to business law is no exception. In virtually every area of practice, social media have been a curse or a blessing, and sometimes both. The benefits social media provide by enabling the immediate dissemination of information to a large number of people and the ability to obtain vast amounts of information through social networks, is also a potential trap, exposing attorneys and their clients to a wide range of potential liabilities. And this area is very dynamic – as the use of social media expands, legislatures, courts, regulatory agencies, and other entities are rushing to grapple with the issues social media present while at the same time trying to anticipate developing practices that may implicate their mandates.

In this issue, we will explore four facets of the effect of social media on business law.

In the Threat of Social Media Diligence on the Confidentiality of the M&A Process: The Problem and Possible Solutions, Jonathan Gworek discusses the use of social media as part of the M&A diligence process, and the threats to the transactional confidentiality posed by social media due diligence, such as a potential acquirer’s employee’s becoming aware of multiple LinkedIn reviews of his or her profile by persons associated with the target company and potential breach of contract claims from lost confidentiality. In his article, Jonathan provides some possible solutions, and discusses as well some related issues.

In 10 Tips for Avoiding Ethical Lapses When Using Social Media, Christina Vasilii Harvey, Mac R. McCoy, and Brook Sneath focus on legal ethics issues, and discuss a range of considerations applicable to the use of social media by lawyers, including whether postings by lawyers may constitute legal advertising or prohibited solicitations, implicate duties of confidentiality, or constitute impermissible communications with represented parties or unrepresented third parties. The tips are far-ranging, and also address whether online activities may be deemed to constitute the unlicensed practice of law, and whether it is proper to “friend” a judge.

In Discovery and Preservation of Social-Media Evidence, Margaret (Molly) DiBianca discusses the role of social media as a source of evidence, and the duties that arise from the that role, including the obligation to preserve social media evidence, social media discovery, and the means by which social media can be accessed. The burgeoning of social media has changes the landscape of much litigation discovery and, as the article notes, parties and counsel are well advised to adjust their thinking so that social media is seen as just another type of electronically stored information.

In Privacy and Social Media, Ted Claypoole reviews some of the implications arising from the sharing of personal information through social media sites, and some of the recent legislative and regulatory efforts to address perceived problems in this area, including misrepresentation of privacy policies, consequences of security breaches, rights of employers to access and monitor employee presence on social media sites, disclosures about tracking policies, and a recent effort in California to enable younger users to delete their posts from social media sites.

We hope that you find these articles to be of interest to you, both in your practices and in your personal lives.

I would like to express my appreciation to Ann Yvonne Walker for her assistance in assembling this issue.

—Jeffrey W. Rubin
Delaware LLC’s and the Implied Covenant of Good Faith and Fair Dealing
By Lewis H. Lazarus and Jason C. Jowers
November 2011

BLS Programs
Material Library
Navigating Ethical Quandries in the Social Media Age: How do the Rules Impact a Lawyer’s Favorite Social Media Activities? (PDF)
2013 Committee Meeting
Presented by: Consumer Financial Services

Things My Ethics Professor Didn’t Tell Me: Top Ethical Pitfalls for the Social Media (PDF) (Audio)
2013 Annual Meeting
Presented by: Young Lawyer, Consumer Financial Services, Cyberspace, Professional Responsibility

To Tweet or Not to Tweet: What Boards of Directors and Those Who Advise Them Need to Know about Corporate Uses of Social Media and Avoiding Potential Minefields (PDF) (Audio)
2013 Annual Meeting
Presented by: Corporate Governance, Cyberspace, Federal Regulation of Securities
The Threat of Social Media Diligence on the Confidentiality of the M&A Process: The Problem and Possible Solutions

By Jonathan D. Gworek

The buyer and seller in a merger and acquisition (M&A) process often place a high value on the importance of maintaining a confidential process. A buyer is sensitive to the possibility that any leak could invite unwanted competition for the deal. A seller worries that widespread knowledge about an impending M&A transaction and the uncertainty that knowledge creates might cause an unwanted business distraction. Or worse, a seller may fear that if the pending deal becomes known to the public and ultimately falls through, the seller will be left with less leverage among the remaining buyers and could be labeled “damaged goods.” Both parties also frequently share a range of concerns about managing the content and timing of an announcement of an M&A transaction to a wide range of constituents such as investors, customers, and suppliers. Against this backdrop, the widespread use of the Internet and social media in everyday business practices makes it increasingly difficult to maintain confidentiality in a variety of business settings, including M&A. In particular, the increasing use of social media by buyers for purposes of conducting due diligence on a target can easily “tip off” people who would otherwise be unaware. This article looks at the very practical impact of the Internet and “social media diligence” on the confidentiality in M&A transactions and suggests certain practices that the parties might adopt to both mitigate and more fairly allocate this risk.

Social Media’s Role in Diligence

In the early stages, the parties to a prospective M&A transaction often limit information about the pending transaction to key members of seller’s management and the buyer’s M&A diligence team. The parties may intend for this tight control on information to remain in place through the actual closing. While buyers may also desire the same level of confidentiality, the buyer also has to complete a large due diligence review of the seller’s business and operations. The buyer can expedite this process by accessing information that sits in the public domain, whether on the seller’s website or through social media like LinkedIn and Facebook. For example, if the target is a high technology company, the buyer’s technical diligence team may be tasked with assessing the technical capabilities of the seller’s engineering and product development team. While the chief technology officer and certain other senior technical employees of the seller may have a biography on the seller’s website, this is not likely to be the case below the C-level employee. The most efficient way for the buyer to gather the information necessary to make this initial assessment and create an internal report on the seller’s technical team – before moving to the more advanced diligence stage involving joint team meetings and interviews – is likely to be via the review of such publicly available profiles. The same diligence exercise could be performed by the buyer across multiple departments of the seller in parallel.

Risk of Lost Confidentiality Associated with Social Media Diligence

While this practice might seem both efficient and relatively innocuous from the buyer’s perspective, there are inherent risks that result from this approach to diligence. Perhaps the most obvious example of this arises when an employee at the seller notices an inordinate amount of activity on his/her LinkedIn page originating from personnel at the buyer. Upon noticing this trend, this employee may naturally stop and won-
under what is underlying this sudden indication of interest. It is not hard to imagine that one such attuned and inquisitive employee might be all that it takes for broader speculation to begin around the seller’s water cooler. And if this type of social network diligence is detected by multiple seller employees in parallel, broader speculation is almost certainly going to result. Once this happens, the confidentiality of the pending M&A transaction has essentially been blown internally at the seller. At this point the seller’s management has a problem. At minimum it has a distracted employee base. And while the horse may not have yet completely left the barn, the rest of the connected world – including customers, suppliers and the media, to name a few – is one ill-fated Tweet away from being on notice of the pending M&A transaction as well.

Breach of Contract Damages Resulting from Lost Confidentiality

As if the prospect of lost confidentiality is not bad enough, this chain of events could well put the seller in technical breach of the confidentiality agreement between the buyer and seller and at risk for any damages the buyer may incur as a result of this breach. A typical M&A confidentiality provision prohibits not just the use or disclosure of the confidential information of the other party received during the diligence process, but also extends to any information related to the potential transaction itself, including the simple fact that the parties ever entered into discussions. Such agreements typically put the risk of breach on each party in the event of a breach of the agreement by any “director, officer, employee or agent” of such party. Therefore, any leak outside of the company by an employee arising out of the facts described in the prior section could well constitute a breach of the confidentiality agreement by such person’s employer. But the leak need not necessarily be outside the company in order to constitute a breach. If the confidentiality agreement limits those seller employees who may be made aware of the transaction and anyone outside of this group learns of the pending M&A transaction, this type of leak could also constitute a seller breach even though the information has not left the company. The damages could be significant in either case. For example, if a second potential buyer learns of the pending sale transaction and as a result makes a successful topping bid and emerges as the buyer, the seller could be saddled with a significant contingent liability in the form of a claim brought by the prior bidder. This would be an unfortunate result. In light of the fact that it was brought about by the prior bidder’s diligence methods in the first instance, this may also be considered an unfair result.

Possible Solutions

Both the buyer and seller can take steps to reduce the risk that such an inadvertent leak might occur. One simple way to accomplish this is for the parties to agree that the buyer will not perform any diligence on the target employees using social media. This would require the buyer to obtain the necessary information another way, presumably directly from the seller or other public sources. Recognizing that this may not be practical, an alternative would be to permit the buyer to perform social media diligence, but to require that the diligence be done in a way that does not result in a “tipping off” to target employees by deploying settings that allow the searching party to remain “anonymous” to the target employees. The following provision would accomplish this objective, where “Purpose” refers to the mutual pursuit of the M&A transaction:

The Buyer shall not use the Internet, including without limitation social networking sites, in connection with diligence or other prospective targets. This information can be leveraged into an advantage in the M&A process.

Possible Solutions

Both the buyer and seller can take steps to reduce the risk that such an inadvertent leak might occur. One simple way to accomplish this is for the parties to agree that the buyer will not perform any diligence on the target employees using social media. This would require the buyer to obtain the necessary information another way, presumably directly from the seller or other public sources. Recognizing that this may not be practical, an alternative would be to permit the buyer to perform social media diligence, but to require that the diligence be done in a way that does not result in a “tipping off” to target employees by deploying settings that allow the searching party to remain “anonymous” to the target employees. The following provision would accomplish this objective, where “Purpose” refers to the mutual pursuit of the M&A transaction:

The Buyer shall not use the Internet, including without limitation social networking sites, in connection with diligence or otherwise, to ascertain information about the Seller or its employees, if such practice could inform or alert any employee or consultant of the Seller that the Buyer and the Seller are engaged in discussions regarding the Purpose.

Assuming the parties are in agreement that a buyer’s careless diligence practices should not create a risk of breach to the seller, the confidentiality agreement should be further modified to reflect this allocation of risk. The appropriate provision could operate as a limited exception to the general rule described above that shifts the risk of breach to the seller for the actions of its directors, officers, employees, or agents. The following “tipping exception” serves this purpose when used in conjunction with the prior provision that restricts social media diligence:

Notwithstanding anything to the contrary set forth herein, the Seller shall not be responsible for a breach of the confidentiality provisions of this agreement if the breach occurs directly or indirectly as a result of the Buyer engaging in activities that violate the provisions of this Agreement prohibiting the use of the Internet, including without limitation social networking sites, to obtain information about the Seller or its employees.

Related Issues

While the scenario described above may be the most obvious source of concern that arises out of Internet and social media diligence, it is certainly not the only one. There are less direct ways in which Internet and social media diligence can leave evidence trails that may provide either the buyer or the seller – or even a third party – with information that can be leveraged into an advantage in the M&A process.

For example, LinkedIn has a view box called “People Also Viewed” that leaves trails of useful business information. This view box shows some of the other profiles that viewers of a certain LinkedIn profile have also recently viewed. This view box information can be used in a variety of ways to infer useful information, none of which require much technical savvy or resourcefulness by today’s standards. Using this feature, a seller might be able to ascertain whether or not the M&A team at the buyer that is viewing its employee profiles is also viewing the employee profiles of other prospective targets. This information might be used by the seller to infer that it is the sole target of the buyer. If the seller...
previously had reason to believe that the buyer was also looking at an alternative acquisition – and possibly using this perception as a point of leverage, whether directly or indirectly – this information might give the seller renewed conviction in the negotiation process. Alternatively, a seller that previously thought it was the only object of the buyer’s affection might look at its employee view boxes and infer that the buyer is in fact doing similar diligence on another prospective target in lieu of the seller. This knowledge could cause the seller to behave more conservatively in the negotiation process. Either way, this is meaningful information to the seller and has been provided to the seller by the buyer indirectly through its social media diligence efforts. This is by no means a one way street. The buyer could use the data to ascertain whether the seller is talking to other potential buyers. And third parties can also monitor this data to make inferences about when a specific company – buyer or seller – might be engaged in an M&A process, and with whom. All of this can be avoided if the buyer and seller either agree not to use social media diligence, or use it in a more limited or discrete manner.

While not a by-product of social networks per se, the parties should also bear in mind the fact that web analytics used by the seller can also be a source of information that could tip off its employees. Even without accessing social media, if a buyer’s M&A team is spending an inordinate amount of time browsing the seller’s website, web analytics tools used by the buyer will likely flag this activity to certain employees within the seller’s company. This could similarly trigger broad speculation among seller employee base.

Conclusion

In summary, the use of the Internet and social media diligence poses risks to the confidentiality of an M&A process and can also leave “fingerprints” that can be used to draw other useful inferences. The stakes are high and the parties in an M&A process would be well served to consider precautions to establish mutually agreeable business processes that will be used during diligence in order to mitigate these risks. The parties should also address allocation of risk in the event that these safeguards are not sufficient.

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The ubiquitous nature of social media has made it an unrivaled source of evidence. Particularly in the areas of criminal, personal-injury, employment, and family law, social media evidence has played a key role in countless cases. But the use of social media is not limited to these practice areas. Businesses of every size can be affected by social media – both in the duty to preserve social media content and in the desire to access relevant social media evidence in litigation.

**The Duty to Preserve Social Media Evidence**

Data residing on social media platforms is subject to the same duty to preserve as other types of electronically stored information (ESI). The duty to preserve is triggered when a party reasonably foresees that evidence may be relevant to issues in litigation. All evidence in a party’s “possession, custody, or control” is subject to the duty to preserve. Evidence generally is considered to be within a party’s “control” when the party has the legal authority or practical ability to access it.

As an initial matter, social media content should be included in litigation-hold notices instructing the preservation of all relevant evidence. Once the litigation-hold notice has been issued, parties have available to them a number of ways to preserve social media data, depending on the particular platform or application at issue.

**Methods of Preservation**

Facebook offers the ability to “Download Your Info.” With just one click of the mouse, users can download a zip file containing timeline information, posts, messages, and photos. Information that is not available by merely logging into an account also is included, such as the ads on which the user has clicked, IP addresses that are logged when the user accesses his or her Facebook account, as well as other potentially relevant information.

Twitter offers a similar, although somewhat limited, option. Twitter users can download all Tweets posted to an account by requesting a copy of the user’s Twitter “archive.” Twitter does not, however, offer users a self-serve method of obtaining other, non-public information, such as IP logs. To obtain this additional information, users must request it directly from Twitter by sending an e-mail to privacy@twitter.com with the subject line, “Request for Own Account Information.” Twitter will respond to the e-mail with further instructions.

Although these self-help methods can be an excellent start, they do not address all possible data. Therefore, it may be prudent to employ the assistance of a third-party vendor in order to ensure complete preservation. CloudPreservation and X1 Social Discovery are two examples of commercially available tools that are specifically designed for archiving and collecting social media content.

**Consequences of Failing to Preserve**

Regardless of the method employed, preservation of social media evidence is critically important and the consequences of failing to preserve can be significant. In the worst case, both counsel and client may be subject to sanctions for a failure to preserve relevant evidence. In the first reported decision involving sanctions in the social media context, *Lester v. Allied Concrete Co.*, No. CL08-150 (Va. Cir. Ct. Sept. 01, 2011), aff’d, No. 120074 (Va. Ct. App. Jan. 10, 2013), the court sanctioned both the plaintiff and his counsel based, in large part, on its determination that they had engaged in spoliation of social media evidence. In that case, the lawyer told his paralegal to make sure the plaintiff “cleaned up” his...
Facebook page. The paralegal helped the plaintiff to deactivate his page and delete 16 pictures from his account. Although the pictures were later recovered by forensic experts, the court found that the sanctions were warranted based on the misconduct.

In contrast to Lester, a federal court in New Jersey imposed a significantly less severe remedy for the removal of Facebook posts. In Katiroll Company, Inc. v. Kati Roll and Platters, Inc., No. 10-3620 (GEB) (D.N.J. Aug. 3, 2011), the court determined that the defendant committed technical spoliation when he changed his Facebook profile picture, where the picture at issue was alleged to show infringing trade dress. Because the defendant had “control” over his Facebook page, he had the duty to preserve the photos.

Because the photos were relevant to the litigation, their removal was “somewhat prejudicial” to the plaintiff. Instead of harsh monetary or evidentiary sanctions though, the court ordered a more practical-driven resolution. Specifically, the court ordered the defendant to coordinate with the plaintiff’s counsel to change the picture back to the allegedly infringing picture for a brief time during which the plaintiff could print whatever posts it believed to be relevant.

Critical to the court’s decision not to award sanctions was its finding that the plaintiff had not explicitly requested that the defendant preserve his Facebook account as evidence. The court concluded, instead, that it would not have been immediately clear to the defendant that changing his Facebook profile picture would constitute the destruction of evidence. Thus, any spoliation was unintentional. This decision supports the idea that counsel should consider issuing a litigation-hold notice to opposing parties, as well as to one’s own client.

Even inadvertent negligence for which sanctions are not warranted, can result in the loss of potentially relevant social media evidence. For example, in In re Pfizer, Inc. Securities Litigation, 288 F.R.D. 297 (S.D.N.Y. Jan. 8, 2013), the plaintiff-shareholders sought sanctions against Pfizer for failing to preserve data from “e-rooms.” The “e-rooms” were internal collaboration applications maintained by the company for use by employees in sharing documents and calendars, archiving e-mails, and communicating via discussion boards and instant messaging. Although the company had preserved (and produced) a tremendous amount of ESI, it had failed to preserve the data associated with the relevant e-rooms.

The court took issue with the scope of Pfizer’s litigation-hold measures because they did not include e-rooms. Although documents and information included in the e-rooms were likely also maintained elsewhere and had likely been preserved and produced, the deletion of the e-rooms had resulted in the loss of discoverable information concerning the manner in which the employees internally organized information.

The court found that this information was relevant because it would allow the plaintiffs to draw connections and understand the narrative of events in a way “not necessarily afforded by custodial production.” Thus, the court concluded, the company breached its duty to preserve because the scope of its litigation hold did not include the e-rooms. Sanctions, however, were not warranted because the conduct was merely negligent and the plaintiffs had not shown that any lost data was, indeed, relevant to their claims.

Preservation in a “BYOD” World

One question that remains unanswered relates to the obligation of a company to preserve the potentially relevant social media content of its employees. In Cotton v. Costco Wholesale Corp., No. 12-2731 (D. Kan. July 24, 2013), the court denied the employee-plaintiff’s motion to compel text messages sent or received by employees on their personal cell phones, finding that the employee had failed to show that the employer had any legal right to obtain the text messages. In other words, the phones and the data they contained were not in the “possession, custody, or control” of the employer. This recent discussion is one of the first of its kind and observers will have to wait to see whether the approach is adopted by other courts in cases to come.

The Discoverability of Social Media

Preservation of social media evidence, of course, is only one part of the process. Parties will want to obtain relevant social media evidence as part of their informal and formal discovery efforts. Although some courts continue to struggle with disputes involving such efforts, discovery of social media merely requires the application of basic discovery principles in a somewhat novel context.

No Reasonable Expectation of Privacy

The user’s right to privacy is commonly an issue in discovery disputes involving social media. Litigants continue to believe that messages sent and posts made on their Facebook pages are “private” and should not be subject to discovery during litigation. In support of this, litigants claim that their Facebook pages are not publicly available but, instead, are available only to a limited number of designated Facebook “friends.” Courts consistently reject this argument, however. Instead, courts generally find that “private” is not necessarily the same as “not public.” By sharing the content with others – even if only a limited number of specially selected friends – the litigant has no reasonable expectation of privacy with respect to the shared content. Thus, the very purpose of social media – to share content with others – precludes the finding of an objectively reasonable expectation that content will remain “private.” Consequently, discoverability of social media is governed by the standard analysis and is not subject to any “social media” or “privacy” privilege.

Relevancy as the Threshold Analysis

Relevancy, therefore, becomes the focus of the discoverability analysis. Courts are wary about granting discovery of social media content where the requesting party has not identified some specific evidence tending to show that relevant information exists. However, a requesting party is only able to satisfy this burden if at least some part of producing party’s social media con-
tent is publicly available. Thus, when a litigant’s social-networking account is not publicly available, the likelihood of its discovery diminishes significantly. As more and more users understand the importance of privacy settings, the burden on the requesting party becomes more and more difficult to satisfy.

**Methods of Access to Social Media Evidence**

Assuming a litigant is able to meet its burden to establish the relevancy of social-networking content, the question becomes a practical one – how to obtain the sought-after information? Currently, this question has no good answer. There have been a variety of methods requested by litigants and ordered by the courts, with mixed degrees of success.

**Direct Access to Social Media Accounts**

One of the most intrusive methods of discovery is to permit the requesting party access to the entire account. If analogized to traditional discovery, this would be the equivalent of granting access to a litigant’s entire office merely because a relevant file is stored there. Not surprisingly, this method of “production” has not been popular with parties or with courts.

Nevertheless, there are several decisions in which a court has ordered a party to produce his or her login and password information to the other side in response to a discovery request. One of these decisions, *Largent v. Reed*, No. 2009-1823 (Pa. C.C.P. Nov. 8, 2011), illustrates some of the procedural challenges that can result.

In *Largent*, the court ordered the plaintiff to turn over her Facebook login information to defense counsel within 14 days of the date of the order. Defense counsel then would have 21 days to “inspect [the plaintiff’s] profile.” After that period, the plaintiff could change her password to prevent any further access to her account by defense counsel. Although the order specifically identified the defendant’s lawyer as the only party who would be given the login information, it did not specify whether the defendant was permitted to view the account’s contents once the attorney had logged in.

Another case involving the exchange of login information resulted in more serious and permanent harm. In *Gatto v. United Airlines, Inc.*, No. 10-1090-ES-SCM (D.N.J. Mar. 25, 2013), the plaintiff voluntarily provided his Facebook password to the defendants’ counsel during a settlement conference facilitated by the court. When the defendants’ attorney later logged into the account and printed portions of the plaintiff’s profile page as previously agreed, Facebook sent an automated message to the plaintiff, alerting him that his account had been accessed from an unauthorized ISP address.

The plaintiff attempted to deactivate the account but deleted it instead. As a result, all of the data associated with the account was automatically and permanently deleted 14 days later. The court found that the plaintiff had failed to preserve relevant evidence and granted the defendants’ request for an adverse-inference instruction as a sanction.

Not all courts have endorsed the idea of direct access to a party’s social media account. One court went so far as to hold that a blanket request for login information is *per se* unreasonable. In *Trail v. Lesko*, No. GD-10-017249 (Pa. C.C.P. July 3, 2012), both sides sought to obtain Facebook posts and pictures from the other. Neither complied and both parties filed motions seeking to compel the other to turn over its Facebook password and username.

The court explained that a party is not entitled to free-reign access to the non-public social-networking posts of an opposing party merely because he asks the court for it. “To enable a party to roam around in an adversary’s Facebook account would result in the party to gain access to a great deal of information that has nothing to do with the litigation and [] cause embarrassment if viewed by persons who are not ‘Friends.’”

One court went even further. In *Chauvin v. State Farm Mutual Automobile Insurance Company*, No. 10-11735, 2011 U.S. Dist. LEXIS 121600 (S.D. Mich. Oct. 20, 2011), the court affirmed an award of sanctions against the defendant due to its motion to compel production of the plaintiff’s Facebook password. The court upheld the decision of the magistrate judge, who had concluded that the content the defendant sought to discover was available “through less intrusive, less annoying and less speculative means,” even if relevant. Furthermore, there was no indication that granting access to the account would be reasonably calculated to lead to discovery of admissible information. Thus, the motion to compel warranted an award of sanctions.

**In Camera Review**

In an effort to guard against overly broad disclosure of a party’s social media information, some courts have conducted an *in camera* review prior to production. For example, in *Offenback v. Bowman*, a No. 1:10-cv-1789, 2011 U.S. Dist. LEXIS 66432 (M.D. Pa. June 22, 2011), the magistrate judge conducted an *in camera* review of the plaintiff’s Facebook account and ordered the production of a “small segment” of the account as relevant to the plaintiff’s physical condition.

In *Douglas v. Riverwalk Grill, LLC*, No. 11-15230, 2012 U.S. Dist. LEXIS 120538 (E.D. Mich. Aug. 24, 2012), the court ordered the plaintiff to provide the contents for *in camera* review. After conducting its review of “literally thousands of entries,” the court noted that “majority of the issues bear absolutely no relevance” to the case. In particular, the court found that the only entries that could be considered discoverable were those written by the plaintiff, which could be in the form of “comments” he made on another’s post or updates to his own “status.” The court identified the specific entries it had determined were discoverable.

Many courts, understandably, have been less than enthusiastic about the idea of doing the parties’ burdensome discovery work. For example, in *Tomkins v. Detroit Metropolitan Airport*, 278 F.R.D. 387 (E.D. Mich. 2012), the court declined the parties’ suggestion that it conduct an *in camera* review, explaining that “such review is ordinarily utilized only when necessary to
resolve disputes concerning privilege; it is rarely used to determine relevance.”

At least one court has agreed to “friend” a litigant for the purpose of conducting an in camera review of the litigant’s Facebook page. In *Barnes v. CUS Nashville, LLC*, No. 3:09-cv-00764, 2011 U.S. Dist. LEXIS 143892 (M.D. Tenn. June 3, 2010), the magistrate judge offered to expedite the parties’ discovery dispute by creating a Facebook account and then “friending” two individuals “for the sole purpose of reviewing photographs and related comments in camera.” The judge then would “properly review and disseminate any relevant information to the parties . . . [and would] then close Facebook account.”

**Attorneys’ Eyes Only**

In *Thompson v. Autoliv ASP, Inc.*, No. 2:09-cv-01375 (D. Nev. June 20, 2012), the defendant obtained information from the plaintiff’s publicly available social-networking profiles that was relevant to the case, but asserted that the plaintiff had since changed her account settings to prevent the defendant from further access and had failed to produce (or had produced in overly-redacted form) information from these profiles in response to the defendant’s formal discovery requests.

The defendant sought to have the court conduct an in camera review of the profiles in their entirety to determine whether the plaintiff’s discovery responses were complete. Instead, the court ordered the plaintiff to provide the requested information to the defendant’s counsel for an attorney’s-eyes-only review for the limited purpose of identifying whether information had been improperly withheld from production. The defendant’s counsel was instructed that it could not use the information for any other purpose without a further ruling by the court.

**Third-Party Subpoenas**

While the discoverability analysis is a product of the common law, there is at least one statute relevant to the discussion. The Stored Communications Act (SCA) limits the ability of Internet-service providers to voluntarily disclose information about their customers and subscribers. Although providers may disclose electronic communications with the consent of the subscriber, the SCA does not contain an exception for disclosure pursuant to civil discovery subpoena. The application of the SCA to discovery of communications stored on social-networking sites has produced mixed results.

Providers, including Facebook, take the position that the SCA prohibits them from disclosing social media contents, even by subpoena. From Facebook’s website:

> Federal law prohibits Facebook from disclosing “user content (such as messages, Wall (timeline) posts, photos, etc.), in response to a civil subpoena. Specifically, the Stored Communications Act, 18 U.S.C. § 2701 et seq., prohibits Facebook from disclosing the contents of an account to any non-governmental entity pursuant to a subpoena or court order.

One of the earliest cases to address the issue, *Crispin v. Christian Audigier, Inc.*, 717 F. Supp. 2d 965 (C.D. Cal. 2010), concluded that the SCA prohibited a social-networking site from producing a user’s account contents in response to a civil discovery subpoena. In that case, the defendants served subpoenas on several third parties, including Facebook and MySpace, seeking communications between the plaintiff and another individual. The plaintiff moved to quash the subpoenas.

The court held that plaintiff had standing to bring the motion, explaining that “an individual has a personal right in information in his or her profile and inbox on a social-networking site and his or her webmail inbox in the same way that an individual has a personal right in employment and bank records.” Moreover, the court determined that the providers were electronic communication service (ECS) providers under the SCA and were thus prohibited from disclosing information contained in “electronic storage.”

The SCA does not override a party’s obligation to produce relevant ESI, though. To the contrary, a party must produce information that is within its possession, custody, or control. Thus, a court can compel a party to execute an authorization for the release of social media content. With an executed authorization, a properly issued subpoena, and, in most cases, a reasonably small payment for associated costs, litigants can obtain all information related to a user’s social media account.

**Lessons Learned**

Although the world of social media and other new technology continues to present novel questions, the answers are often derived by applying a “pre-Facebook” analysis. For example, businesses understand that they have an obligation to preserve potentially relevant evidence. Social media evidence is no different and should be preserved in the same way as paper documents and emails.

Similarly, parties in litigation are entitled to discovery of all relevant, non-privileged information. Thus, social media content is subject to discovery, despite the privacy settings imposed by the account user. Nevertheless, only relevant information must be produced and it is the responsibility of counsel to make the relevancy determination.

Parties and counsel are well advised to adjust their thinking so that social media becomes just another type of ESI. And, like emails and other forms of electronic data, social media must be preserved and is subject to discovery if relevant to the dispute.

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You may be among the thousands of legal professionals flocking to social media sites like LinkedIn, Facebook, Twitter, or Google+ to expand your professional presence in the emerging digital frontier. If so, have you paused to consider how the ethics rules apply to your online activities? You should. Some of the ethical constraints that apply to your social media usage as a legal professional may surprise you. Moreover, legal ethics regulators across the country are beginning to pay close attention to what legal professionals are doing with social media, how they are doing it, and why they are doing it. The result is a patchwork quilt of ethics opinions and rule changes intended to clarify how the rules of professional conduct apply to social media activities.

This article provides 10 tips for avoiding ethical lapses while using social media as a legal professional. The authors cite primarily to the ABA Model Rules of Professional Conduct (RPC) and select ethics opinions from various states. In addition to considering the general information in this article, you should carefully review the ethics rules and ethics opinions adopted by the specific jurisdiction(s) in which you are licensed and in which your law firm maintains an office.

1. Social Media Profiles and Posts May Constitute Legal Advertising

Many lawyers – including judges and in-house counsel – may not think of their social media profiles and posts as constituting legal advertisements. After all, legal advertising is limited to glossy brochures, highway billboards, bus benches, late-night television commercials, and the back of the phonebook, right? Wrong. In many jurisdictions, lawyer and law firm websites are deemed to be advertisements. Because social media profiles (including blogs, Facebook pages, and LinkedIn profiles) are by their nature websites, they too may constitute advertisements.

For example, the Florida Supreme Court recently overhauled that state’s advertising rules to make clear that lawyer and law firm websites (including social networking and video sharing sites) are subject to many of the restrictions applicable to other traditional forms of lawyer advertising. Similarly, California Ethics Opinion 2012-186 concluded that the lawyer advertising rules in that state applied to social media posts, depending on the nature of the posted statement or content.

2. Avoid Making False or Misleading Statements

The ethical prohibition against making false or misleading statements pervades many of the ABA Model Rules, including RPC 4.1 (Truthfulness in Statements to Others), 4.3 (Dealing with Unrepresented Person), 4.4 (Respect for Rights of Third Persons), 7.1 (Communication Concerning a Lawyer’s Services), 7.4 (Communication of Fields of Practice and Specialization), and 8.4 (Misconduct), as well as the analogous state ethics rules. ABA Formal Opinion 10-457 concluded that lawyer websites must comply with the ABA Model Rules that prohibit false or misleading statements. The same obligation extends to social media websites.

South Carolina Ethics Opinion 12-03, for example, concluded that lawyers may not participate in websites designed to allow non-lawyer users to post legal questions where the website describes the attorneys answering those questions as “experts.” Similarly, New York State Ethics Opinion 972 concluded that a lawyer may not list his or her practice areas under the heading “specialties” on a social media site unless the lawyer is appropriately certified as a specialist – and law firms may not do so...
at all.

Although most legal professionals are already appropriately sensitive to these restrictions, some social media activities may nevertheless give rise to unanticipated ethical lapses. A common example occurs when a lawyer creates a social media account and completes a profile without realizing that the social media platform will brand the lawyer to the public as an “expert” or a “specialist” or as having legal “expertise” or “specialties.” Under RPC 7.4 and equivalent state ethics rules, lawyers are generally prohibited from claiming to be a “specialist” in the law. The ethics rules in many states extend this restriction to use of terms like “expert” or “expertise.” Nevertheless, many professional social networking platforms (e.g., LinkedIn and Avvo) may invite lawyers to identify “specialties” or “expertise” in their profiles, or the sites may by default identify and actively promote a lawyer to other users as an “expert” or “specialist” in the law. This is problematic because the lawyer completing his or her profile cannot always remove or avoid these labels.

3. Avoid Making Prohibited Solicitations

Solicitations by a lawyer or a law firm offering to provide legal services and motivated by pecuniary gain are restricted under RPC 7.3 and equivalent state ethics rules. Some, but not all, state analogues recognize limited exceptions for communications to other lawyers, family members, close personal friends, persons with whom the lawyer has a prior professional relationship, and/or persons who have specifically requested information from the lawyer.

By its very design, social media allows users to communicate with each other or the public at-large through one or more means. The rules prohibiting solicitations force legal professionals to evaluate—before sending any public or private social media communication to any other user—whom the intended recipient is and why the lawyer or law firm is communicating with that particular person. For example, a Facebook “friend request” or LinkedIn “invitation” that offers to provide legal services to a non-lawyer with whom the sending lawyer does not have an existing relationship may very well rise to the level of a prohibited solicitation.

Legal professionals may also unintentionally send prohibited solicitations merely by using certain automatic features of some social media sites that are designed to facilitate convenient connections between users. For instance, LinkedIn provides an option to import e-mail address books to LinkedIn for purposes of sending automatic or batch invitations. This may seem like an efficient option to minimize the time required to locate and connect with everyone you know on LinkedIn. However, sending automatic or batch invitations to everyone identified in your e-mail address book could result in networking invitations being sent to persons who are not lawyers, family members, close personal friends, current or former clients, or others with whom a lawyer may ethically communicate. Moreover, if these recipients do not accept the initial networking invitation, LinkedIn will automatically send two follow-up reminders unless the initial invitation is affirmatively withdrawn. Each such reminder would conceivably constitute a separate violation of the rules prohibiting solicitations.

4. Do Not Disclose Privileged or Confidential Information

Social media also creates a potential risk of disclosing (inadvertently or otherwise) privileged or confidential information, including the identities of current or former clients. The duty to protect privileged and confidential client information extends to current clients (RPC 1.6), former clients (RPC 1.9), and prospective clients (RPC 1.18). Consistent with these rules, ABA Formal Opinion 10-457 provides that lawyers must obtain client consent before posting information about clients on websites. In a content-driven environment like social media where users are accustomed to casually commenting on day-to-day activities, including work-related activities, lawyers must be especially careful to avoid posting any information that could conceivably violate confidentiality obligations. This includes the casual use of geo-tagging in social media posts or photos that may inadvertently reveal your geographic location when traveling on confidential client business.

There are a few examples of lawyers who found themselves in ethical crosshairs after posting client information online. For example, in In re Skinner, 740 S.E.2d 171 (Ga. 2013), the Georgia Supreme Court rejected a petition for voluntary reprimand (the mildest form of public discipline permitted under that state’s rules) where a lawyer admitted to disclosing information online about a former client in response to negative reviews on consumer websites. In a more extreme example, the Illinois Supreme Court in In re Peshek, M.R. 23794 (Ill. May 18, 2010) suspended an assistant public defender from practice for 60 days for, among other things, blogging about clients and implying in at least one such post that a client may have committed perjury. The Wisconsin Supreme Court imposed reciprocal discipline on the same attorney for the same misconduct. In re Disciplinary Proceedings Against Peshek, 798 N.W.2d 879 (Wis. 2011).

Interestingly, the Virginia Supreme Court held in Hunter v. Virginia State Bar, 744 S.E.2d 611 (Va. 2013), that confidentiality obligations have limits when weighed against a lawyer’s First Amendment protections. Specifically, the court held that although a lawyer’s blog posts were commercial speech, the Virginia State Bar could not prohibit the lawyer from posting nonprivileged information about clients and former clients without the clients’ consent where (1) the information related to closed cases and (2) the information was publicly available from court records and, therefore, the lawyer was free, like any other citizen, to disclose what actually transpired in the courtroom.

5. Do Not Assume You Can “Friend” Judges

In the offline world, it is inevitable that lawyers and judges will meet, network, and sometimes even become personal friends. These real-world professional and personal
relationships are, of course, subject to ethical constraints. So, too, are online interactions between lawyers and judges through social media (e.g., becoming Facebook “friends” or LinkedIn connections) subject to ethical constraints.

Different jurisdictions have adopted different standards for judges to follow. ABA Formal Opinion 462 recently concluded that a judge may participate in online social networking, but in doing so must comply with the Code of Judicial Conduct and consider his or her ethical obligations on a case-by-case (and connection-by-connection) basis. Several states have adopted similar views, including Connecticut (Op. 2013-06), Kentucky (Op. JE-119), Maryland (Op. 2012-07), New York (Op. 13-39, 08-176), Ohio (Op. 2010-7), South Carolina (Op. 17-2009), and Tennessee (Op. 12-01).

In contrast, states like California (Op. 66), Florida, Massachusetts (Op. 2011-6), and Oklahoma (Op. 2011-3) have adopted a more restrictive view. Florida Ethics Opinion 2009-20, for example, concluded that a judge cannot friend lawyers on Facebook who may appear before the judge because doing so suggests that the lawyer is in a special position to influence the judge. Florida Ethics Opinion 2012-12 subsequently extended the same rationale to judges using LinkedIn and the more recent Opinion 2013-14 further cautioned judges about the risks of using Twitter. Consistent with these ethics opinions, a Florida court held that a trial judge presiding over a criminal case was required to recuse himself because the judge was Facebook friends with the prosecutor. See Domville v. State, 103 So. 3d 184 (Fla. 4th DCA 2012).

6. Avoid Communications with Represented Parties

Under RPC 4.2 and equivalent state ethics rules, a lawyer is forbidden from communicating with a person whom the lawyer knows to be represented by counsel without first obtaining consent from the represented person’s lawyer. Under RPC 8.4(a) and similar state rules, this prohibition extends to any agents (secretaries, paralegals, private investigators, etc.) who may act on the lawyer’s behalf.

These bright-line restrictions effectively prohibit lawyers and their agents from engaging in social media communications with persons whom the lawyer knows to be represented by counsel. This means that a lawyer may not send Facebook friend requests or LinkedIn invitations to opposing parties known to be represented by counsel in order to gain access to those parties’ private social media content. In the corporate context, San Diego County Bar Association Opinion 2011-2 concluded that high-ranking employees of a corporation should be treated as represented parties and, therefore, a lawyer could not send a Facebook friend request to those employees to gain access to their Facebook content.

On the other hand, viewing publicly accessible social media content that does not precipitate communication with a represented party (e.g., viewing public blog posts or Tweets) is generally considered fair game. That was the conclusion reached by Oregon Ethics Opinions 2013-189 and 2005-164, which analyzed viewing public social media content to reading a magazine article or a published book.

7. Be Cautious When Communicating with Unrepresented Third Parties

Underlying RPC 3.4 (Fairness to Opposing Party and Counsel), 4.1 (Truthfulness in Statements to Others), 4.3 (Dealing with Unrepresented Person), 4.4 (Respect for Rights of Third Persons), and 8.4 (Misconduct), and similar state ethics rules is concern for protecting third parties against abusive lawyer conduct. In a social media context, these rules require lawyers to be cautious in online interactions with unrepresented third parties. Issues commonly arise when lawyers use social media to obtain information from third-party witnesses that may be useful in a litigation matter. As with represented parties, publicly viewable social media content is generally fair game. If, however, the information sought is safely nestled behind the third party’s privacy settings, ethical constraints may limit the lawyer’s options for obtaining it.

Of the jurisdictions that have addressed this issue, the consensus appears to be that a lawyer may not attempt to gain access to non-public social media content by using subterfuge, trickery, dishonesty, deception, pretext, false pretenses, or an alias. For example, ethics opinions in Oregon (Op. 2013-189), Kentucky (Op. KBA E-434), New York State (Op. 843), and New York City (Op. 2010-2) concluded that lawyers are not permitted (either themselves or through agents) to engage in false or deceptive tactics to circumvent social media users’ privacy settings to reach non-public information. Ethics opinions by other bar associations, including the Philadelphia Bar Association (Op. 2009-02) and the San Diego County Bar Association (Op. 2011-2), have gone one step further and concluded that lawyers must affirmatively disclose their reasons for communicating with the third party.

8. Beware of Inadvertently Creating Attorney-Client Relationships

An attorney-client relationship may be formed through electronic communications, including social media communications. ABA Formal Opinion 10-457 recognized that by enabling communications between prospective clients and lawyers, websites may give rise to inadvertent lawyer-client relationships and trigger ethical obligations to prospective clients under RPC 1.18. The interactive nature of social media (e.g., inviting and responding to comments on a blog post, engaging in Twitter conversations, or responding to legal questions posted by users on a message board) creates a real risk of inadvertently forming attorney-client relationships with non-lawyers, especially when the objective purpose of the communication is the consumer’s perspective is to consult with the lawyer about the possibility of forming a lawyer-client relationship regarding a specific matter or legal need. Of course, if an attorney-client relationship attaches, so, too, do the attendant obligations to maintain the confidentiality of client information and to avoid conflicts of interest.
Depending upon the ethics rules in the jurisdiction(s) where the communication takes place, use of appropriate disclaimers in a lawyer’s or a law firm’s social media profile or in connection with specific posts may help avoid inadvertently creating attorney-client relationships, so long as the lawyer’s or law firm’s online conduct is consistent with the disclaimer. In that respect, South Carolina Ethics Opinion 12-03 concluded that “[a]ttempting to disclaim (through buried language) an attorney-client relationship in advance of providing specific legal advice in a specific matter, and using similarly buried language to advise against reliance on the advice is patently unfair and misleading to laypersons.”

9. Beware of Potential Unauthorized Practice Violations

A public social media post (like a public Tweet) knows no geographic boundaries. Public social media content is accessible to everyone on the planet who has an Internet connection. If legal professionals elect to interact with non-lawyer social media users, then they must be mindful that their activities may be subject not only to the ethics rules of the jurisdictions in which they are licensed, but also potentially the ethics rules in any jurisdiction where the recipient(s) of any communication is(are) located. Under RPC 5.5 and similar state ethics rules, lawyers are not permitted to practice law in jurisdictions where they are not admitted to practice. Moreover, under RPC 8.5 and analogous state rules, a lawyer may be disciplined in any jurisdiction where he or she is admitted to practice (irrespective of whether he or she provides or offers to provide legal services. It is prudent, therefore, for lawyers to avoid online activities that could be construed as the unauthorized practice of law in any jurisdiction(s) where the lawyer is not admitted to practice.

10. Tread Cautiously with Testimonials, Endorsements, and Ratings

Many social media platforms like LinkedIn and Avvo heavily promote the use of testimonials, endorsements, and ratings (either by peers or consumers). These features are typically designed by social media companies with one-size-fits-all functionality and little or no attention given to variations in state ethics rules. Some jurisdictions prohibit or severely restrict lawyers’ use of testimonials and endorsements. They may also require testimonials and endorsements to be accompanied by specific disclaimers. South Carolina Ethics Opinion 09-10, for example, provides that (1) lawyers cannot solicit or allow publication of testimonials on websites and (2) lawyers cannot solicit or allow publication of endorsements unless presented in a way that would not be misleading or likely to create unjustified expectations. The opinion also concluded that lawyers who claim their profiles on social media sites like LinkedIn and Avvo (which include functions for endorsements, testimonials, and ratings) are responsible for conforming all of the information on their profiles to the ethics rules.

Lawyers must, therefore, pay careful attention to whether their use of any endorsement, testimonial, or rating features of a social networking site is capable of complying with the ethics rules that apply in the state(s) where they are licensed. If not, then the lawyer may have no choice but to remove that content from his or her profile.

Conclusion

Despite the risks associated with using social media as a legal professional, the unprecedented opportunities this revolutionary technology brings to the legal profession to, among other things, promote greater competency, foster community, and educate the public about the law and the availability of legal services justify the effort necessary to learn how to use the technology in an ethical manner. E-mail technology likely had its early detractors and, yet, virtually all lawyers are now highly dependent on e-mail in their daily law practice. Ten years from now, we may similarly view social media as an essential tool for the practice of law.

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From every angle, social media is anathema to privacy. The very founding concept of paleolithic AOL chatrooms and Usenet newsgroups, and later Facebook, MySpace, and the earliest blogging sites was to provide a forum for people to share with each other. People shared ideas, humor, emotions, preferences, prejudices, priorities, and often misguided attempts at profundity. Newer sites simply broadened and deepened the sharing – Twitter users share commute times and coffee temperatures, Tumblers share memes galore, and Instagramites share a wealth of doctored photographs.

We learned things about the people in our world, and they about us. Thanks to social media, we now know that if our nearest coworker were a tree, she would be a willow, and the celebrity she believes that she most resembles is Angelina Jolie. We also know that Shirley’s kids are honor students and that Tom’s brother was just released from prison (early, for good behavior), that Jeffrey lives and dies with his Eagles and that Sandra is so, so sad at the plight of shelter animals. Importantly, we know when people are leaving town and how long they will be gone. We know if they come into money. We learn about their families and their vulnerabilities. We learn about drinking and drug use, sexual promiscuity, and even crimes like DWI or hit and run. We see pictures of their kids, their cars, their vacations, and their homes.

All of this sharing may help create communities, but it also destroys privacy. The bikini-clad body that is perfectly appropriate on the beach at St. John or Captiva may undermine the respect an employee has worked hard to earn from superiors, subordinates, and peers at the office who may view the vacation pictures on Facebook. The same may be true for pictures of a drinking party among friends. Too much published information can and will present obstacles when circumstances change and a spouse sues for divorce, or a rival is seeking an edge for a promotion at work. We all know that kids can be the cruel, and your insistence on wearing mouse ears at a Disney theme park may reach the attention of your children’s classmates, and their parents. Criminals trawl social media constantly, looking for vulnerabilities and vacations, pinpointing easy targets.

Operators of various social media outlets are well aware that their profits may increase as we expand our willingness to share personal information about ourselves, and much of the business model development for social media sites is designed to coerce, cajole, trick, taunt, or tease us into revealing more information about our lives and our thoughts and opinions. Who are your friends? What discounts interest you? You “liked” the last Vin Diesel movie, will you like the next one? What is your relationship status? Who do you write to? Who do you poke? Won’t you download the mobile app so we can see where you are when you access our site? Your friends have downloaded our app. Why won’t you? We will ask you again in two hours.

Every bit of information we disclose is another databite to be mined and measured, sorted and sold. Online transactions provide even more opportunities, because a purchase through a social media site hits the trifecta for the site owner. With a purchase, the site registers our activity, our expenditure, our degree of interest in a good or service and an entire category of goods or services (opening our wallet demonstrates significant interest), our bank, our credit card information, our shipping address, our online ID, and our passwords. In addition, the social media site may trumpet the sale to our friends attempting to induce additional transactions. And beyond this
extraordinary information bounty, the social media site likely received a financial kickback from a sale made from its platform. Moreover, the data mining industry attempts to review every transaction and every posting in which we engage in order to be able to maximize the profit potential of every piece of information disclosed by that transaction or posting.

For this reason, social media is not simply a collection of online places that allow private information to escape, but social media sites are organized to draw as much participation and information out of us as possible. Like casinos built without sunlight or clocks so as to encourage your further play, the social media sites and data mining industry study online behavior and build manipulation machines designed to entice you to remain engaged and to divulge information. A search engine site may not care whether you own a particular make or model of car or that you baked cookies last night, but it cares that you told them about your car and your cookies. They make money from aggregating car owners and cookie bakers and selling information to companies who can exploit that information.

Until recently, there has been very little counterbalance to the siren’s call of revealing everything on social media or to the tricks and manipulations that the online media companies employ to make sharing easy, satisfying, and seemingly so necessary. Certainly there are authors writing jeremiads both in and out of the mainstream media who will despair about the morality of kids today, or about the solipsistic adults who believe that each workout or restaurant meal is worth recording for posterity and circulating to wide circle of “friends.” There seems to be an absence of concerted opposition to this kind of activity. Schools and workplaces do not appear to actively discourage sharing in social media, except to prevent a student from bullying another, or to caution workers not to release company trade secrets. Governmental restrictions are spotty at best, except for the intelligence services, judiciary, and some government agencies.

In short, prior to 2013, legislatures and regulators in the United States appeared to be more concerned about the data they could glean from social media than protecting privacy of the average citizen in the online world. Much of the rest of the industrialized world has a very different viewpoint about personal information than that we experience in the United States. In Europe, Canada, and other countries across the world, protection of each citizen’s private information is considered to be a human right, secured by statute and enforced by government and private causes of action. In the United States, by contrast, only certain classes of information are protected under federal law – financial transactions, health care transactions, and information regarding children under the age of 13 – while nearly all other data is considered to be fair game for any business or government agency that chooses to collect, store, and use the information.

The Federal Trade Commission (FTC) and state attorneys general have been the traditional protectors of online privacy for lightly-regulated industries like social media. But through much of the development of social media and socially-oriented Internet sites, these enforcement agencies have tended only to enforce the privacy policies that a site chose to publicize. If a social media site had claimed not to gather certain information, but it indeed gathered that information, then the FTC would assert claims upon that site. However, if the social media site had a vague privacy policy that never clearly disclosed all of the information it gathered, or if the site gathered and sold massive amounts of personal data from its users, and the site revealed its behavior in its privacy policy, then no enforcement action would be initiated because the site was not breaking any known laws. (The exception to this rule seemed to be the 2006 ruling against Choicepoint, costing the company $10 million in civil penalties for providing personal information to identity thieves.) In other words, for most personal data about people, their activities, and their transactions, it seems that a social media site would not be regulated for use or abuse of this data, only for misrepresenting what data was collected and how such data was used. Deep intrusions of privacy may be allowed, as long as the site doesn’t directly misrepresent what it is doing.

The FTC has moved beyond this position during the past three years by using its powers to enforce privacy policies on social media sites to sue transgressors, and then to force the transgressive sites into settlements that include a long-term consent order permitting the FTC to have a tighter grip on the site’s policies. For example, in November 2011, the FTC claimed that Facebook had lied to consumers by repeatedly stating that personal information would be kept private, while repeatedly allowing that personal information to be shared and made public. In settling this claim, Facebook agreed to a 20-year consent order protecting its member’s privacy in more specific ways. That agreement mandates that Facebook receive explicit consent of its users before disclosing private information. Following up on this, in September 2013, the FTC announced an inquiry into whether Facebook’s proposed new privacy policies, disclosed in August 2013, violated the 20-year consent agreement. In its proposed new policies, Facebook was planning to use its members’ names and pictures in advertising products the members had “liked” or for which they had given a favorable comment, and the new policy provided that Facebook automatically assumed that the parents of teenage Facebook users had granted permission for their children’s names to be used in advertising. The original FTC claim relating to an allegedly misleading privacy policy has thereby enabled the FTC to exercise much greater influence into Facebook’s future treatment of consumer data. The FTC also has obtained similar 20-year consent orders in place with Twitter, MySpace, and Google.

State breach notice laws affecting social media privacy have some relatively consistent elements and some experimental elements. These laws address the way that a social media company must behave after a breach of security relating to a site-
A social media site might have trouble meeting its obligations with respect to breaches because for each user whose account was compromised, the site must determine if the exposure included private data beyond that company’s privacy settings would trigger these laws. For example, if a Texas social media user had set her account to “friends only,” and the social media site exposed her account more broadly, then the site would be subject to state law breach notice requirements.

A social media site might have trouble meeting its obligations with respect to breaches because for each user whose account was compromised, the site must determine if the exposure included private and legally protected subject matter as defined in each applicable statute. Rather than undertake this Herculean task, the site may determine simply to notify all its members about the mistake, whether or not such notice is mandated by a particular state law. Of course, as with other enterprises, social media companies that accept credit card payments or otherwise keep customer financial account data are expected to protect this data and are obligated to notify customers where financial data was compromised.

As social media grows in importance in many American lives, states are tackling specific aspects of privacy intrusions that are raised in the news and that capture the imagination of legislators and the public. For example, the concern about disclosure of personal information on social media sites has manifest in the field of worksite protections. In the past two years, a new wave of privacy laws has been sweeping state legislatures; at this writing, 12 states currently have laws specifically restricting employers from demanding access to their employees’ social media sites when those sites are not fully public. (The states that have passed these laws are Arkansas, California, Colorado, Illinois, Maryland, Michigan, New Jersey, New Mexico, Nevada, Oregon, Utah, and Washington.) Nearly all of these laws were passed in 2013, and other legislatures are currently considering legislating similar employer restrictions. One of the newest and broadest of these laws, passed in September 2013 and signed into law in New Jersey, prohibits employers from seeking access to “a person account,” such as a friends-only account at Facebook. Further, the law prohibits employers from “shoulder surfing” or making an employee access a personal account while management watches, from requiring an applicant or employee to change the privacy settings on a restricted account to a less-restrictive setting so that the employer can access it, or by forcing the employee to accept an employer’s “friend” request. The law also prohibits an employer from retaliating or discriminating against a job applicant or employee for refusing to provide log-in information to the employer, for reporting violations of this law to the New Jersey Commissioner of Labor, or from testifying or participating in an investigation into a violation of the law.

The New Jersey law contains exceptions for financial service firms that are required by statute to monitor employees’ social media communications. Similarly, in September of 2013, Illinois amended its social media password law to exempt the financial services sector, because many companies in this sector — banking, securities sales, and insurance — are required to monitor certain employee’s correspondence of all types with customers or prospective customers. Most states with laws in this space have broad definitions of the type of sites protected. For example, the recently passed Nevada statute classifies a social media account as “any electronic service or account or electronic content, including, without limitation, videos, photographs, blogs, video blogs, podcasts, instant and text messages, electronic mail programs or service, online services or Internet website profiles.” The penalties for these laws vary widely, with California, Colorado, Illinois, New Jersey, and Oregon creating administrative remedies; Illinois, Maryland, Michigan, Oregon, Utah, and Washington providing a private right of action (some with penalty caps); and Arkansas, Nevada, and New Mexico not addressing remedies at all in their statutes. Other aspects of the laws vary by state. Oregon bans colleges from asking for social media passwords. Washington allows employers to be granted access to social media sites when making factual determinations in the course of conducting an investigation. New Mexico’s restrictions only apply to job applicants and not to employees.

Despite these laws, employers are still allowed to review social media pages that are available to the general public, and employees may volunteer access to their social media accounts or may choose to “friend” work associates, including their superiors. Taking advantage of these voluntary actions does not violate any of the new social media forced access laws. However, because of the recent trend toward increasing the protection accorded to personal online accounts and communications, employers should document how they obtained any social media information regarding employees how they obtained access to it. The trend toward increased protection is not uniform, though, and highlights uncertainty in a number of jurisdictions as to the degree to which privacy in social media...
should be protected. Most states have not approved such protections, and those that have passed a password protection law are inconsistent with respect to penalties, definitions, and the scope of protections.

California is taking steps to protect the privacy of some social media users from users’ own poor judgments. In autumn 2013, California enacted a law that would require social media sites to allow young registered users to erase their own comments from the sites. This is a first step in the United States toward the “right to be forgotten” that has been debated in Europe over the past decade. Teens who may have posted embarrassing statements will now have the right to clear those statements from the site’s memory banks. The mechanism for enforcement has not as yet been determined, but we do know some of the limitations of the law. The statute only covers the teen’s own posts and not posts made by others. A child can only erase his or her own statements, not the comments, “like” buttons, or other posts surrounding those statements. (A new case has ruled that use of the “like” button on social media is constitutionally protected speech. Bland v. Roberts, Case No. 12 – 1671, 4th Cir., September 18, 2013.) A teen cannot erase pictures of him or herself that others have posted, or statements about that teen that third parties posted, no matter how embarrassing or offensive those pictures or statements may be. The Library of Congress is currently archiving public tweets on Twitter, and other third-party sites archive social media data. These archive sites are not covered by the California law. And from a policy standpoint, is there a downside to permitting young bullies, racists, and fraudsters to eliminate the evidence of their statements? Although some of this speech may have legal implications and may be required in court proceedings, under the new California law these statements may be required to be deleted.

In an equally bold move, in 2013 the California legislature also addressed the broad concern of consumers who are being silently tracked by software over the Internet. Tracking tools used by social media are one of the ways these sites derive revenues, capturing user’s behavior and then selling targeted advertising designed to match or appeal to the type of behavior a specific user exhibits. Many sites use persistent beacons, cookies, and other tools that follow a person’s web usage and send information about that user’s visits and habits to the site or other third parties. Some Internet browser programs are now including anti-tracking technology, permitting a user to attempt to reject these monitoring tools or at least to advise sites that use the tools that this user does not wish to be tracked in this way. California’s new law will not force sites to stop tracking consumers, and it will not even force those sites to acknowledge and follow “do not track” instructions received by consumer’s browser. Instead, the California law requires companies to disclose whether the sites will honor “do not track” instructions from their users. Presumably, it is thought that Internet surfers will avoid sites that do not honor such requests. It is also likely that the California attorney general’s office, which fought for this law, will be posting a “naughty and nice” list of companies which will and won’t respect their user’s wishes not to be tracked. This law follows several years of failure by Internet sites (including social media) and privacy advocates to agree on a method permitting people to opt-out of being tracked online. It is unlikely that the California law will itself cause major changes in social media company behavior, but this is the first statute to advance the conversation on tracking of private online movements, and it could lead to further action by legislatures across the country.

Led by the states, the United States is developing laws and regulations to protect certain aspects of people’s information on social media. As social media sites evolve to make the dissemination of information easier, our society is beginning to recognize the problems inherent in such dissemination, and the use and protections to which such information is entitled. Both the FTC and state legislatures are taking steps to protect the American public from inappropriate intrusions on their privacy through social media – even if they are only protecting us from our own poor judgment.

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Pursuant to Delaware law, all capital stock, by default, is created equal unless the company’s certificate of incorporation provides for certain classes or series of preferred stock that enjoy special contractual rights, powers, and preferences over shares of another class or series of capital stock. While the General Corporation Law of the State of Delaware (the DGCL) permits a company to create preferred stock, it provides drafters of preferred stock provisions with no specific guidance as to the nature or form of the preferred stock’s rights and obligations. Similarly, Delaware case law imposes few express mandates other than to require that shares of preferred stock have preference over shares of common stock (which typically takes the form of a preference as to dividends and/or distributions upon liquidation of the company).

With few requirements from the DGCL and Delaware case law, it is up to the drafter to set forth the particular terms, including the rights, powers, and preferences of the preferred stock. The terms of the preferred stock, particularly the economic rights, powers, and preferences, will be influenced by the context in which the preferred stock is being issued and the relative bargaining power of the company and its investors.

The special rights, powers, and preferences typically associated with preferred stock consist of some combination of special dividends, liquidation, voting, redemption and/or conversion rights, and such rights, powers, and preferences must be clearly and specifically set forth in the company’s certificate of incorporation or in a certificate of designation (which has the effect of amending the company’s certificate of incorporation). For purposes of this article, a certificate of incorporation and a certificate of designation are referred to collectively as a “certificate of incorporation.”

The interpretation of the special contractual preferences of preferred stock is primarily governed by the principles of contract law. In addition, preferred stock provisions must be interpreted in the context of the DGCL and the case law interpreting it. Drafters of preferred stock provisions are deemed to have been aware of and have an understanding of such applicable laws. If a preferred stockholder asserts a claim related to a contractual right, power, or preference of the preferred stock, Delaware courts will interpret such rights, powers, and preferences as contractual rather than fiduciary in nature.

On the other hand, preferred stockholders have rights that are separate from those created by their contractual preferences. These separate rights are shared equally with the common stockholders and are fiduciary in nature. If a preferred stockholder asserts a claim related to a right that is not a preference, but instead is shared equally with the common stockholders, Delaware courts have suggested that both the preferred and common stockholders are owed fiduciary duties. For example, if preferred and common stockholders are entitled to vote on a certain matter, the directors’ duty to disclose all material information related to the matter extends to all of the company’s stockholders. If there is a divergence of interests between the holders of the preferred stock and common stock, however, it will generally be the duty of board of directors to prefer the interests of the common stockholders to those of the preferred stockholders. As a result, directors could be found to have breached their fiduciary duties if they favor the interests of the preferred stockholders under these circumstances.

Accordingly, precise legal drafting is the key to ensuring that a preferred stockholder’s investment is adequately protected. The special rights, powers, and preferences of the preferred stock must be expressed
clearly and will not be presumed. This article sets forth common drafting pitfalls of which drafters of preferred stock provisions should be cognizant. Most of these pitfalls can be avoided by remembering one simple concept when drafting preferred stock provisions: the special rights, powers, or preferences of preferred stock must be expressed clearly and will not be presumed or implied.

Protecting Protective Provisions

Among the most highly negotiated contractual provisions related to preferred stock are the so-called “protective provisions,” which are contained in the certificate of incorporation and set forth a list of actions that the company cannot take without the prior consent of a specified percentage of the outstanding preferred stock. As its name implies, these provisions seek to protect the investment of the preferred stockholders from actions by the company that may dilute or diminish their investment. As some holders of preferred stock learned the hard way, however, the absence of a single phrase or the reliance on a general, catch-all provision can result in the elimination or circumvention of some or all of these highly negotiated protective provisions.

Being “Benchmarked”

The absence of the simple phrase “including by merger or otherwise” could ultimately result in the inapplicability of all of the preferred stock protective provisions through amendments effected by merger rather than through a direct amendment to the certificate of incorporation. In Benchmark Capital Partners, IV, L.P. v. Vague, 2002 WL 1732423 (Del. Ch. July 15, 2002), aff’d, 822 A.2d 396 (Del. 2003), Benchmark Capital Partners (Benchmark) purchased shares of preferred stock of Juniper Financial Corp. (Juniper) in exchange for certain provisions in Juniper’s certificate of incorporation to protect Benchmark’s investment. These protective provisions included the requirement that Juniper obtain Benchmark’s consent prior to taking any action that would “materially adversely change the rights, preferences and privileges” of Benchmark’s preferred stock.

Several years later, when Juniper was in need of additional financing, Juniper and its potential investor proposed a transaction that would involve an investment of $50 million in financing in Juniper in exchange for shares of a new series of preferred stock of Juniper. In connection with the proposed transaction, Juniper initially considered amending its certificate of incorporation to permit the issuance of the new series of preferred stock, but reconsidered when it realized that Benchmark could invoke its protective provisions to block such action. Instead, to avoid Benchmark’s protective provisions, Juniper merged a wholly owned subsidiary with and into itself and, by virtue of the merger, amended and restated its certificate of incorporation. The amendments to the certificate of incorporation included the creation of a new series of preferred stock and the conversion of Benchmark’s existing preferred stock into a new series of junior preferred stock with diminished rights.

In response, Benchmark filed suit in the Delaware Court of Chancery seeking to preliminarily enjoin the merger on the basis that Juniper failed to obtain the votes required by two of its protective provisions — a series vote of the holders of each series of existing preferred stock on the merger because the amendments would “materially and adversely change the rights, preferences and privileges” of such series, and a class vote of the holders of existing preferred stock because Juniper “authorize[d] or issue[d], or obligate[d] itself to issue, any other equity security . . . senior to or on a parity with” the existing preferred stock. Juniper responded that Benchmark was not entitled to a series or class vote related to the merger because the adverse change to Benchmark’s rights was the result of a merger, as opposed to a direct amendment to the certificate of incorporation, and Benchmark’s protective provisions did not expressly apply to mergers.

The court agreed with Juniper and held that protective provisions drafted to track Section 242(b)(2) of the DGCL (which provides holders of any class of capital stock with a class vote on an amendment to a certificate of incorporation that would “alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely”) do not provide a class vote on a merger including one in which the certificate of incorporation of the surviving corporation is amended in the merger, absent an express provision of the certificate of incorporation to the contrary. Thus, because the protective provisions covering amendments to the certificate of incorporation did not include the phrase “including by merger or otherwise,” Juniper was able to amend its certificate of incorporation by virtue of merger to severely diminish Benchmark’s rights without Benchmark’s consent.

Benchmark is consistent with decisions of the Delaware Supreme Court, including Elliott Associates, L.P. v. Avatex Corp., 715 A.2d 843 (Del. 1998), that provided a “path” for future drafters of preferred stock provisions. The Supreme Court noted that when a charter “grants only the right to vote on an amendment, alteration or repeal, the preferred have no class vote in a merger,” but when a charter “adds the terms ‘whether by merger, consolidation or otherwise’ and a merger results in an amendment, alteration or repeal that causes an adverse effect on the preferred, there would be a class vote.” As a result, drafters of preferred stock provisions should be cognizant of this “path” and draft protective provisions accordingly.

Being “Cracked”

Preferred stock provisions frequently provide that all shares of convertible preferred stock will convert automatically into shares of common stock upon the consent of the holders of a majority of the preferred stock. Where different series of preferred stock have different economic rights or protective provisions, holders of a series of preferred stock that do not own enough shares to block such an automatic conversion may lose their special economic rights or protective provisions if the holders of a majority of the preferred stock determine...
to convert the preferred stock into common stock. In *Greencastle Capital Partners I, L.P. v. Mary’s Gone Crackers, Inc.*, 2012 WL 4479999 (Del. Ch. Sept. 28, 2012), the Delaware Court of Chancery considered whether, under Delaware law and the terms of the company’s certificate of incorporation, Mary’s Gone Crackers had the power to implement an automatic conversion of all of the shares of its Series A and Series B preferred stock into shares of common stock and subsequently to amend the certificate of incorporation to remove all references to the preferred stock (including its rights, powers, and preferences) without the consent of the holders of the Series B preferred stock.

Under the company’s certificate of incorporation, a vote of the majority of the holders of the outstanding shares of Series A and Series B preferred stock (voting together) had the right to automatically convert their shares into shares of common stock. Because the holders of the Series A preferred stock (who enjoyed fewer benefits under the certificate of incorporation than the holders of the Series B preferred stock) owned a majority of the total shares of preferred stock, the holders of the Series A preferred stock had the ability to automatically convert all of the shares of the outstanding Series A and Series B preferred stock into common stock without the consent of the holders of the Series B preferred stock. In early 2012, Mary’s Gone Crackers solicited and received consents from a sufficient number of holders of the Series A preferred stock to effect the automatic conversion of all of the shares of the company’s preferred stock into shares of common stock.

A holder of the Series B preferred stock filed suit in the Delaware Court of Chancery claiming that the consent of the holders of the Series B preferred stock was required to effect the automatic conversion (and subsequently to amend the charter) based on certain protective provisions contained in the company’s certificate of incorporation, including consent rights over the company’s ability to take any action that would alter or change the powers, preferences, and rights of the Series B preferred stock. The court disagreed and held that the automatic conversion provision in the certificate of incorporation is a right of the holders of the preferred stock. Accordingly, the automatic conversion by the holders of a majority of the preferred stock to common stock was an effectuation of that right and was not an alteration or change to a right of the Series B preferred stock. The court noted that had the drafters of the preferred stock provisions intended for an automatic conversion to be subject to the consent rights of the holders of the Series B preferred stock, they could have expressly listed that right among the other consent rights of the holders of the Series B preferred stock. Because the holders of Series B preferred stock did not expressly bargain for the right to consent to any automatic conversion of the preferred stock, the holders of the Series A preferred stock were able to exercise the automatic conversion right and convert all of the shares of the preferred stock into common stock without the consent of the holders of the Series B preferred stock.

**What About Subsidiaries?**

When drafting preferred stock protective provisions that prevent the company from taking certain actions without the vote or consent of the holders of the company’s existing preferred stock, drafters should be aware that such provisions will not necessarily apply to any subsidiary of the company. Unless subsidiaries are specifically included within the scope of this protective provision, a subsidiary of the company could take actions that the company would otherwise be prevented from taking without the prior consent or vote of the preferred stockholders. For example, in *In re Sunstates Corp. Shareholder Litigation*, 788 A.2d 530 (Del. Ch. 2001), the Delaware Court of Chancery considered whether a preferred stock protective provision prohibiting the company from repurchasing its own shares when dividends were in arrears applied to purchases of the company’s stock by its subsidiaries. Consistent with prior decisions holding that the special rights of preferred stock must be expressed clearly, the court held that the relevant protective provision, which did not expressly provide that it applied to any subsidiary of the company, did not apply to purchases of the company’s stock by its subsidiaries. Further, the court noted that if the investors wished to prevent subsidiaries of the company from making such repurchases, they could have done so by including of the phrase “or permit any subsidiary of the company to take any such action.”

**“No Impairment” Clauses**

Protective provisions often include a “no impairment” clause, which typically provides that a company will not take any action that would impair the rights, powers, and preferences of the holders of the company’s existing preferred stock. In *WatchMark Corp. v. ArgoGlobal Capital, LLC*, 2004 WL 2694894 (Del. Ch. Nov. 4, 2004), the Delaware Court of Chancery rejected an argument that a “no impairment” clause operated as a gap filler to confer consent rights over actions that were not specifically addressed by the protective provisions in the certificate of incorporation. Delaware courts will not infer rights that are not expressly set forth in the certificate of incorporation, and thus “no impairment” clauses cannot be relied upon to provide protection that is not otherwise specifically granted.

**Consider Your Exit When You Enter**

In *In re Trados Inc. Shareholder Litigation*, 2013 WL 4511262 (Del. Ch. Aug. 16, 2013), the Delaware Court of Chancery noted that a typical investor’s investment timeframe is at odds with a company’s perpetual existence. Accordingly, investors whose investment horizon will require the company to engage in a liquidity event in a finite time period need to consider their exit strategy when they invest. If there is a divergence of interests between the holders of the preferred stock and common stock in a sale because, for example, all of the sale proceeds would go to the preferred stock and none of it would reach the common stock, it will generally be the duty of the board of directors to prefer the inter-
ests of the common stockholders to those of the preferred stockholders. In fact, directors could breach their fiduciary duties if they favor the interests of the preferred stockholders under these circumstances. In Trados, the court identified several contractual exit provisions to address the difficult fiduciary duty issues that can arise if such contractual exit rights are not present. These options include contractual drag-along rights requiring other stockholders to sell their shares to a purchaser if a majority of the stockholders approve the sale, put rights allowing the stockholder to put their stock to the company at a predesigned price after a fixed period of time, or a contractual agreement with the company to commence a sales process after a fixed period of time. Each of these options has limitations but, given the difficult fiduciary duty issues in the absence of such rights, consideration should be given at the time of investment to having a contractual exit strategy.

Make Your Vote Count

In order to maintain control over their investment in the company, preferred stockholders often negotiate for certain special voting rights in exchange for their investment in the company. Any such voting rights must not only be clearly and specifically set forth, but they also must be carefully drafted to ensure that they are consistent with Delaware law and are included in the proper organizational document of the company.

Set Forth Election and Voting Rights

The most important voting right of preferred stockholders is often the right to designate a certain number of directors to the company’s board of directors. Under Delaware law, however, unless the certificate of incorporation provides otherwise, the majority of the stockholders of the company are entitled to elect all of the directors of the company. Thus, in order to provide preferred stockholders with the ability to designate a certain number of directors to the company’s board of directors, the election and voting rights of the preferred stockholders must be included in the certificate of incorporation. Election and voting rights of preferred stock that are only set forth in an investor rights agreement or a voting agreement and are not also included in a certificate of incorporation may not be specifically enforceable under Delaware law.

Vacancies to be Filled in Same Manner as Appointed

Many companies include a provision in their certificate of incorporation or bylaws that provides that any vacancy in a board seat may be filled by a majority of directors then in office. These provisions typically purport to apply regardless of whether the board seat was elected by a particular class or series of stock. It is not clear, however, that such a provision will work to fill a vacancy in a board seat that was elected by a particular class or series of stock. Section 223(a)(2) of the DGCL provides that, unless otherwise provided in the certificate of incorporation or the bylaws, “[w]henver the holders of any class or classes of stock or series thereof are entitled to elect 1 or more directors by the certificate of incorporation, vacancies and newly created directorships of such class or classes or series may be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected.”

The inclusion of the permissive term “may” suggests that the procedure for filling vacancies and newly created directorships is merely permissive and is not exclusive of other mechanisms that may be set forth in the certificate of incorporation or the bylaws. Thus, vacancies in seats elected by the holders of a particular class or series of preferred stock may, unless expressly provided otherwise, be filled by other stockholders. Drafters should be aware of such potential issues and consider providing that any vacancies must be filled in the same manner as the director who was originally appointed to the board of directors and may not be filled in any other manner.

Eliminate Common Stockholders’ Ability to Vote on Amendments to Preferred Stock Provisions

Once preferred stock has been issued, regardless of whether it was created by a stockholder-approved amendment to the certificate of incorporation or by the board of directors in a certificate of designation pursuant to blank check authority, the terms of that series of preferred stock can only be altered by amending the certificate of incorporation under Section 242 of the DGCL, which requires the approval of all stockholders entitled to vote generally, including the common stockholders. Drafters of preferred stock provisions, however, can provide in the certificate of incorporation that common stockholders are not entitled to vote on any amendment to the certificate of incorporation that relates solely to the terms of one or more series of preferred stock, if the holder of such affected series is entitled to vote on the amendment. As a result, if the parties want to retain the flexibility to seek to change the terms of preferred stock without having to obtain the consent of the common stockholders, they must include a provision to that effect in the certificate of incorporation.

Voting Agreements Should Include an Irrevocable Proxy

In addition to the right to designate certain members of the company’s board of directors, preferred stockholders frequently enter into an agreement with the company and other stockholders to vote their shares for the election of certain designees to the company’s board of directors. Drafters of any such voting agreement should be aware that it may be difficult to enforce such an agreement (other than through costly litigation) if the voting agreement does not include an irrevocable proxy granting the holder of such proxy the power to vote the shares subject to the voting agreement in accordance with the terms of the voting agreement in the event that any party to the voting agreement fails to do so.

Appraisal Rights for Preferred Stock

As a general matter, holders of preferred
stock have the same appraisal rights under Section 262 of the DGCL as the holders of common stock. Unlike common stock, however, the fair value of the preferred stock in an appraisal proceeding is based solely on the contractual rights granted to the preferred shares being appraised under the certificate of incorporation. As a result, the preferred stockholders are only entitled to rights that are clearly and expressly provided to them in the event of a merger in the certificate of incorporation and are not entitled to additional merger consideration through the appraisal process.

Whether a preferred stockholder is entitled to a preference over the common stockholders in a sale of the company depends on the terms of the preferred stock. Often the preferred stock has specific provisions governing its rights in a sale of the company. In the absence of such specific provisions, however, preferences to which preferred stock may be entitled in a “liquidation, dissolution or winding up” of the company will not apply to a merger, particularly where the terms of the preferred stock expressly state that a merger will not be deemed to be a liquidation, dissolution, or winding up for purposes of the liquidation provisions of the preferred stock. In the absence of such specification, the preferred stock will be deemed to have no “preference” over the common stock in a sale and instead will be entitled only to pro rata treatment with the common stock.

In determining the fair value of the preferred stock based on the certificate of incorporation, a Delaware court will not consider speculative or probable contractual features of the preferred stock. For example, in In re Appraisal of Metromedia International Group, Inc., 971 A.2d 893 (Del. Ch. 2009), the Delaware Court of Chancery rejected an argument by preferred stockholders that, in determining the fair value of the company’s preferred stock, the court should consider the preference of the preferred stockholders contained in the certificate of incorporation in connection with a redemption or liquidation because the preferred stockholders argued that it is likely that such an event could occur in the next few years. The court rejected the argument, noting that a redemption or liquidation of the preferred stock was too speculative, and determined that the preferred stockholders were only entitled to receive the amount per share as provided in the certificate of incorporation in the event of a merger.

On the other hand, the court will consider nonspeculative contractual features of the certificate of incorporation in determining the fair value of the preferred stock. For example, in Shiftan v. Morgan Joseph Holdings, Inc., 57 A.3d 928 (Del. Ch. 2012), in the determining the fair value of the company’s preferred stock, the court took into account the economic reality that the preferred stockholders would have been entitled to mandatory redemption of their shares just six months after the merger. Therefore, even though the redemption had not (and would never) take place due to the merger transaction, the fact that, prior to the merger, the redemption was certain to occur in the near-term (within six months) was relevant to the court’s determination of value of the preferred shares in the merger transaction.

Conclusion

As demonstrated by the examples set forth above, the precise words that drafters employ clearly matter in determining the special rights, powers, and privileges of preferred stock. Such rights must be set forth clearly in the certificate of incorporation and will not be presumed by a Delaware court if challenged. Accordingly, drafters should be familiar with the DGCL and the relevant case law and take great care to ensure that all of the desired provisions are clearly expressed and defined at the time of the preferred stockholders’ investment in the company.

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Female Corporate Directors Pay Dividends for Corporations and their Countries

By John Okray

We have all seen news stories discussing which countries are ranked the most prosperous and where citizens are considered the happiest. We spend even more time hearing about how to make companies more efficient and profitable. I thought it would be interesting to analyze what successful countries and companies have in common. After looking at numerous studies and statistics, one thing is clear – successful countries and companies have, on average, more female corporate directors. This is not to suggest that simply adding more female corporate directors will transform a country or company into an outperformer overnight. However, having women participate at the top of the corporate food chain appears to be a byproduct of cultures that meaningfully value equality and diversity. Can it be a coincidence that countries with more female directors tend to be the wealthiest, most prosperous, best educated, least corrupt, and happiest? There are a few situations where a country, like Japan with a low percentage of female directors, will do satisfactorily in one category (GDP per capita), but then meaningfully underperform in others (happiness). However, as research is showing that companies with female directors tend to financially outperform their peers, pressure by shareholders on laggard corporate boards may force change. Moreover, some countries are not waiting for their capital markets to correct the gender imbalance.

Legal Requirements for Female Corporate Directors

A growing number of countries have imposed, or are currently debating, mandatory quotas for female directors. Such a requirement has not been imposed in the United States yet. However, if corporations in both developed and emerging market countries begin to significantly outpace their U.S. peers, this notion may gain traction. It would be unfortunate to get to a point where U.S. corporations must face legal remedial measures in order to have a respectable percentage of female corporate directors.

Norway: In 2002 public limited companies were given until July 2005 to have at least 40% female directors. An extension was granted and compliance was reached in 2009.

Belgium: Plan adopted in 2011 requires public companies and companies listed on its stock exchange to have at least 30% female directors. When a board member leaves, the seat must be filled by a woman until the quota is reached. Companies have between 6 and 8 years, depending on their size, to be in compliance.

France: Law passed in 2011 imposes a quota of 40% female directors by 2017, with a target of 20% by 2014.

Iceland: 2011 law requires 40% corporate directors from each sex for publicly owned and publicly listed companies with more than 50 employees.

Italy: Law passed in 2011 requires that public company boards be at least one-third female by 2015.

European Union: The European Commission has set a target of at least 40% female corporate directors by 2020.

Germany: As of November 2013, a law was expected to be implemented requiring companies registered on the German stock exchange to have at least 30% female directors, and large firms are required to publish their plans for elevating more women into top executive roles.

Spain: Law passed in 2007 requires public companies with more than 250 employees to have at least 40% female directors.
by 2015. Companies that reach quota are given preference for government contracts.

**Malaysia:** Companies with more than 250 employees required to have at least 30% female directors or senior management by 2016.

**United Arab Emirates:** 2012 law requires companies and government agencies to have female directors.

**Netherlands:** Government guidelines suggest at least 30% female directors by 2016 at companies with more than 250 employees. Companies that do not meet the January 1, 2016, deadline must prepare a plan on how they will achieve the quota.

**Austria:** State-owned companies required to have 25% female directors by 2013 and 35% by 2018. Private companies expected to follow these standards voluntarily.

**Israel:** A 1999 law requires at least one female director on public company boards.

**Finland:** As of 2010, all listed companies must have at least one female and one male on the board.

It is worth examining in more detail the factors that countries with an above average percentage of female corporate directors have in common. In order to eliminate any possible bias, I looked at published studies and data from different countries and from governmental, non-governmental, and non-profit organizations. Also included are several categories that could be considered measures of a country’s success. The countries included in the top and bottom 10 tables below are those that appeared in the recent GMI Ratings’ 2013 Women on Board Surveys for which there were a sufficient number of public corporations and amount of data to compare.

### Companies with Female Directors Outperform Financially

In March 2011, the non-profit Catalyst organization released a report titled the **Bottom Line: Corporate Performance and Women’s Representation on Boards (2004–2008)**. The report summarized an analysis of the financial performance of Fortune 500 companies over a five-year period. As shown in Tables 1, 2, and 3, companies with higher representation of female directors over the period significantly outperformed those with low representation by 84 percent on return on sales, by 60 percent on return on invested capital, and by 46 percent on return on equity.

<table>
<thead>
<tr>
<th>Table 1: Return on Sales</th>
<th>Fortune 500 Companies with Three or More Female Directors in Four of Five Years Outperformed Companies with Zero Female Directors by 84%</th>
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<tr>
<td>Return on Sales</td>
<td>Cos. with Zero Female Directors</td>
</tr>
<tr>
<td>15.0%</td>
<td>7.6%</td>
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<tr>
<td>10.0%</td>
<td>5.0%</td>
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<tr>
<th>Table 2: Return on Invested Capital</th>
<th>Fortune 500 Companies with Three or More Female Directors in Four of Five Years Outperformed Companies with Zero Female Directors by 60%</th>
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<tr>
<td>Return on Invested Capital</td>
<td>Cos. with Zero Female Directors</td>
</tr>
<tr>
<td>12.0%</td>
<td>5.5%</td>
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<tr>
<td>8.0%</td>
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<tr>
<th>Table 3: Return on Equity</th>
<th>Fortune 500 Companies with Three or More Female Directors in Four of Five Years Outperformed Companies with Zero Female Directors by 46%</th>
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<tr>
<td>Return on Equity</td>
<td>Cos. with Zero Female Directors</td>
</tr>
<tr>
<td>20.0%</td>
<td>10.5%</td>
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<tr>
<td>15.0%</td>
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<td>10.0%</td>
<td>5.0%</td>
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More recently the Credit Suisse Research Institute released *Gender Diversity and Corporate Performance* in August 2012. Their research spanned 2,360 companies in the MSCI AC World Index (covering 85% of global investable equity markets across 45 countries) and over 14,000 data points from 2005 to 2011. Their report contained a number of noteworthy observations:

- **Better Stock Performance:** The stock prices of large capitalization companies and small-to-mid capitalization companies with women board members both outperformed their peer companies without women board members by 26% and 17%, respectively, over 6 years.
- **Higher Return on Equity:** The average return on equity of companies with at least one woman on the board was 16%, versus only 12% for companies with no female board members.
- **Higher P/BV Multiples:** The price-to-book value for companies with women on the board was 2.4x, a third higher than companies without a female director at only 1.8x.
- **Better Average Growth:** Net income growth for companies with female directors averaged 14% over the six year study, versus only 10% for companies without female directors.

The study authors make two other general observations: (1) It would on average have been better to invest in companies with women on their boards, and (2) a specific consequence of greater board diversity for shareholders is reduced volatility, evidenced through enhanced stability in corporate performance and in share price returns.

Interestingly, the Catalyst and Credit Suisse research reports were not necessarily groundbreaking as they reaffirmed and expanded on previous studies on this topic. For example, in 2007, McKinsey & Company, an international management consulting firm released *Women Matter – Gender Diversity, a Corporate Performance Driver*. Their research suggested that “the companies where women are most strongly represented at board or top-management level are also the companies that perform best.” Specifically, McKinsey conducted two broad studies and concluded:

- **Study 1:** Companies with 3 or more women in top management functions scored higher in a number of key organizational excellence categories than companies with no women at the top - namely work environment and values, direction, coordination and control, leadership, external orientation, motivation, capability, accountability, and innovation.
- **Study 2:** “There can be no doubt that, on average” companies with a higher proportion of women on the executive committee and having at least two women on the board outperformed their sector in terms of return on equity (11.4% versus and average 10.3%), operating result (EBIT 11.1% versus 5.8%), and stock price growth (64% versus 47% between 2005 and 2007).
Prosperous Countries Tend to Have More Female Corporate Directors

*Live Long and Prosper*  
– Mr. Spock

According to the Random House Dictionary, “prosperity” is “a successful, flourishing, or thriving condition, especially in financial respects; good fortune.” The Legatum Institute in London, an independent non-partisan public policy organization, published the comprehensive 2013 Legatum Prosperity Index. This index of national prosperity measures traditional economic indicators as well as well-being and life satisfaction. Sub-indices include economy, entrepreneurship and opportunity, governance, education, health, safety and security, personal freedom, and social capital. Several countries with the highest percentages of female directors received top prosperity rankings (Norway 1st, Canada 3rd, Sweden 4th, Denmark 6th, Australia 7th, Finland 8th), while many of the countries with the lowest percentages of female directors received much lower prosperity rankings (Brazil 46th, Mexico 59th, Russia 61st, Indonesia 69th, India 106th). Interestingly, Norway has topped the Prosperity Index each year since 2009, the same year the country came into full compliance with its 40% female director quota. The United States ranked in 11th on the happiness report. Table 5 compares the average number of female directors at the 10 most prosperous versus the 10 least prosperous countries.

### Table 5: Prosperity v. Avg % of Female Directors

<table>
<thead>
<tr>
<th>10 Most Prosperous Countries</th>
<th>10 Least Prosperous Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>18.0%</td>
<td>8.4%</td>
</tr>
</tbody>
</table>

**Well-Educated Countries Tend to Have More Female Corporate Directors**

The United Nations Development Program compiles data on member states from a number of sources, including from the United Nations Educational, Scientific and Cultural Organization (UNESCO) Institute for Statistics for education. A number of factors are evaluated for education rankings, such as enrollment, literacy, expenditures on education, pupil/teacher ratio, length of education, and graduation rates.

Several countries with high percentages of female directors received top education index rankings (Norway 99.0%, Sweden 91.3%, and Canada 90.8%), while many of the countries with lower percentages of female directors received much lower educational index rankings (China 62.7%, Indonesia 57.7%, and India 45.9%). The United States received a 99.4% education index ranking. Table 6 compares the average number of female directors at the 10 most educated versus the 10 least educated countries.

### Table 6: Education v. Avg % of Female Directors

<table>
<thead>
<tr>
<th>10 Most Educated Countries</th>
<th>10 Least Educated Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.4%</td>
<td>8.2%</td>
</tr>
</tbody>
</table>

**Wealthier Countries Tend to Have More Female Corporate Directors**

Countries with higher average percentages of female directors typically have the highest gross domestic product (GDP) per capita. This includes Norway, Australia, Denmark, Sweden, and Canada ($99,558, $67,036, $56,210, $55,245, and $52,219, respectively). Countries with lower average percentages of female directors usually had much lower GDP per capita, such as Malaysia, Mexico, China, Indonesia, and India ($10,012, $9,747, $6,188, $3,557, and $1,489, respectively). The U.S. GDP per capita was $49,965. Again, Norway with the highest GDP per capita has been in compliance with its 40% female director quota since 2009.

**Less Corrupt Countries Tend to Have More Female Corporate Directors**

According to Transparency International, corruption is the abuse of entrusted...
power for private gain. Corruption has been a major concern for companies doing business globally and is being fought through the enforcement of laws such as the U.S. Foreign Corrupt Practices Act, the Travel Act, and the UK Bribery Act. Transparency International is a non-partisan non-governmental organization that strives to stop corruption and promote transparency, accountability and integrity at all levels and across all sectors of society. Since 1995 they have ranked countries through their Corruption Perception Index.

Denmark, Finland, and Sweden ranked as very low corruption countries (tied for 1st, tied for 1st, and 4th, respectively) and had an average of 22% female directors while Mexico, Indonesia, and Russia ranked as the much more corrupt countries (105th, 118th, and 133rd, respectively) and had an average of 5.5% female directors. The United States ranked in 17th place on the corruption index.

Table 7 compares the average number of female directors at the 10 least corrupt versus the 10 most corrupt countries.

<table>
<thead>
<tr>
<th>Industry Sector</th>
<th>% of Industry with Zero Female Directors</th>
<th>% of Industry with 1 or 2 Female Directors</th>
<th>% of Industry with 3 or More Female Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>25%</td>
<td>61%</td>
<td>14%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>28%</td>
<td>52%</td>
<td>20%</td>
</tr>
<tr>
<td>Energy</td>
<td>61%</td>
<td>38%</td>
<td>1%</td>
</tr>
<tr>
<td>Financials</td>
<td>29%</td>
<td>63%</td>
<td>8%</td>
</tr>
<tr>
<td>Health Care</td>
<td>33%</td>
<td>62%</td>
<td>5%</td>
</tr>
<tr>
<td>Industrials</td>
<td>40%</td>
<td>56%</td>
<td>4%</td>
</tr>
<tr>
<td>Information Technology</td>
<td>49%</td>
<td>48%</td>
<td>3%</td>
</tr>
<tr>
<td>Materials</td>
<td>39%</td>
<td>53%</td>
<td>8%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>55%</td>
<td>38%</td>
<td>7%</td>
</tr>
<tr>
<td>Utilities</td>
<td>6%</td>
<td>69%</td>
<td>26%</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>36%</strong></td>
<td><strong>56%</strong></td>
<td><strong>8%</strong></td>
</tr>
</tbody>
</table>

There are a number of industries that continue to be male dominated, and as a consequence, states that have concentrations of companies within these industries may have a lower percentage of female directors. Looking at states with at least 50 Russell 3000 Index companies, the three worst in terms of having the highest percentage of companies with no female directors are performing information technology sector, and 22% and 12% of Colorado companies are in the energy and information technology sectors, respectively. Conversely, the New York, New Jersey, and Connecticut tri-state area have only a third of their companies with no female directors, supported by 33% of the area’s companies being in the better-than-average financials sector. The Midwest states of Illinois, Minnesota, and Ohio performed even better with only a quarter of companies with no female directors, supported by their higher percentages of companies within the consumer discretionary and consumer staples industries.

Thus, the problem, and potential solution, appears to be one that specific industries could address to avoid unnecessary scrutiny or placing requirements on the entire U.S. capital market. For example, they need a sufficient number of highly qualified senior executives to be good candidates for corporate boards in their industries.

According to the UK Corporate Governance Code, if a director “has served on the board for more than nine years from the date of their first election” it may impact the director’s judgment and make them non-independent. However, in the United States, this corporate governance principle has not been formally adopted yet and thus there are a considerable number of long-tenured directors.

**Spotlight on the United States**

Analyzing the U.S. data reveals that there are geographic areas and industry sectors that have significantly more female directors than others. Texas (52%), California (45%), and Colorado (43%). Factors weighing down these states are that 38% of Texas companies are in the worst performing energy sector, 39% of California companies are in the poorly performing information technology sector, and 22% and 12% of Colorado companies are in the energy and information technology sectors, respectively. Conversely, the New York, New Jersey, and Connecticut tri-state area have only a third of their companies with no female directors, supported by 33% of the area’s companies being in the better-than-average financials sector. The Midwest states of Illinois, Minnesota, and Ohio performed even better with only a quarter of companies with no female directors, supported by their higher percentages of companies within the consumer discretionary and consumer staples industries.

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To put this in better perspective, in order for U.S. companies comprising the broad Russell 3000 Index to attain 40% female directors, they would need to replace 97.21% of male directors with 10 plus years tenure with female directors. However, to get to 30% female directors for the largest of the companies comprising the S&P 500 Index, only 46.49% of the male directors with 10 plus years tenure would need to be replaced with female directors. Companies with an overabundance of long-tenured male directors may ultimately face pressure from investors on both the board diversity and independence corporate governance fronts.

Lack of Female Board Chairs

One problem for corporations globally is the rarity of female board chairs. Almost universally a board chair will have a material impact on the recruitment and selection of new board members. In the United States, female board chairs are found at only 3.0%, 2.5%, and 2.3% of the S&P 500, S&P MidCaps, and S&P SmallCaps Index companies, respectively. The Nordic countries have the greatest percent of female board chairs, but still only comprising 5.6%. Less than 1% of board chairs are females in industrialized Asia, which may explain in part why this area is the worst performing region with only 3% overall female directors. The number of female board chairs is astonishingly low. To correct the overall deficiency of female directors, a focus on board chairs and chairs of nominating committees could be needed.

Conclusion

Corporations have faced a number of high profile corporate governance battles over the last few years – majority voting for directors, pay for performance, say-on-pay advisory votes, shareholder access, environmental issues, etc. Board gender diversity has become a hot topic, or even legal requirement, in many countries, and board gender diversity may be the next battlefront. Directors serving on compensation committees who approved perceived excessive compensation packages were targeted during their next election cycle by a meaningful percentage of institutional investors. Will directors become similarly targeted for failing to nominate a diverse slate of board candidates? Or will the U.S. government or stock exchanges step in to force their hands?

Based on all of the cited studies showing the positive effects of having female corporate directors, it seems there should be little need to implement Byzantine solutions to this perceived problem in the United States. Directors have a fiduciary duty to act in good faith and in the best interests of their companies. They are also hopefully aware of the fact that a majority of U.S. wealth is already controlled by women, a majority of U.S. stock ownership is held by women, women make 80% of healthcare decisions, women have surpassed men in Internet usage and online spending, women make or influence 85% of all purchasing decisions, and women purchase more than 50% of traditional male products including automobiles, home improvement products, and consumer electronics.

If the United States and corporate America want to rise to the top of the rankings, the full and voluntary inclusion of women as corporate directors appears to be a logical first step.

**John Okray is the chair of the Federal Bar Association’s Corporate and Association Counsel Division. The views expressed in this article do not necessarily reflect those of any other person or entity.**
Forum-selection clauses are common and highly useful features of commercial contracts because they help make any future litigation on a contract more predictable for the parties and, in some cases, less expensive. But what procedure should a defendant use to enforce a forum-selection clause when the defendant is sued in a court that is not the contractually selected forum?

On December 3, 2013, the U.S. Supreme Court issued a decision in *Atlantic Marine Construction Co. v. United States District Court for the Western District of Texas* ([___ S.Ct. ___], 2013 WL 6231157 (Dec. 3, 2013)) that answers this question. The Court held that, if the parties’ contract specifies one federal district court as the forum for litigating any disputes between the parties, but the plaintiff files suit in a different federal district court that lawfully has venue (and therefore could be a proper place for the parties to litigate), the defendant should seek to transfer the case to the court specified in the forum-selection clause by invoking the federal statute that permits transfers of venue “[f]or the convenience of the parties and witnesses, in the interest of justice.” If the contract’s forum-selection clause instead specifies a state court as the forum for litigating disputes, the defendant may invoke a different federal statute that requires dismissal or transfer of the case.

Importantly, the Court held that the parties’ contractual choice of forum should be enforced except in the most unusual cases, and that the party resisting the forum-selection clause (i.e., the plaintiff who filed in a different court) has the burden of establishing that public interests disfavoring transfer outweigh the parties’ choice. *Atlantic Marine* is significant for the business community because it provides greater certainty regarding the enforceability of forum-selection clauses, giving commercial parties that employ such clauses in their contracts greater predictability about where they will face future litigation. The Court in *Atlantic Marine* reinforced the strong federal policy favoring the enforcement of such clauses, and clarified the mechanism for their enforcement.

As the Court explained,

> [w]hen parties have contracted in advance to litigate disputes in a particular forum, courts should not unnecessarily disrupt the parties’ settled expectations. A forum-selection clause, after all, may have figured centrally in the parties’ negotiations and may have affected how they set monetary and other contractual terms; it may, in fact, have been a critical factor in their agreement to do business together in the first place. In all but the most unusual cases, therefore, ‘the interest of justice’ is served by holding parties to their bargain.

In *Atlantic Marine*, the U.S. Army Corps of Engineers hired Atlantic Marine Construction to build a child-development center on a military base in Texas. Atlantic Marine subcontracted with another construction company, J-Crew Management, to provide labor and materials. That contract called for all disputes between Atlantic Marine and J-Crew Management to be resolved in the state or federal court in Norfolk, Virginia, where Atlantic Marine is based. But J-Crew Management sued Atlantic Marine in federal court in Texas over Atlantic Marine’s alleged failure to pay for construction work.

Preferring to litigate in Virginia, as the parties had agreed to do, Atlantic Marine asked the federal district court in Texas to enforce the forum-selection clause. It argued that there were two ways that the district court might enforce that clause: under a federal statute that requires the dismissal or transfer of a case brought in the “wrong” venue, or under another federal statute that authorizes a transfer to a more convenient location. (The federal venue statute specifies which federal district or districts are permissible locations for a civil action to be brought, based on the residency of the defendants, the location of the events that are the subject of the suit, or the existence of personal jurisdiction over the defendant.)

The district court denied Atlantic Ma-
Crisp's request under both theories, reasoning that venue was proper in Texas despite the contract's forum-selection clause, and that a convenience transfer was not warranted based on the balance of public and private interests. Atlantic Marine then asked the Fifth Circuit for a writ of mandamus to require the district court to transfer or dismiss the case. Over a dissent that noted the presumptive enforceability of forum-selection clauses, the court of appeals rejected that request.

The Supreme Court granted Atlantic Marine’s request for review to resolve a circuit split over how to enforce a contract provision that selects a federal forum other than the one in which the case was filed.

In a unanimous opinion by Justice Alito, the Supreme Court reversed and remanded. In doing so, it effectively disagreed with both sides of that dispute among the courts of appeals.

The Court first rejected the argument that a forum-selection clause affects whether venue in a given district is “wrong” or “improper,” because the venue statute does not address forum-selection clauses. Accordingly, when a case is filed in a district in which venue is authorized by law, a party seeking to enforce a forum-selection clause must seek transfer to a more convenient forum. A clause selecting a federal forum may be enforced using the statutory convenience transfer, while a clause selecting a state forum may be enforced under the forum non conveniens doctrine.

The Court then described the appropriate standard for transfer. In ordinary cases not involving forum-selection clauses, courts must balance “the convenience of the parties and various public-interest considerations” to determine whether transfer would promote “the interest of justice.” But that analysis shifts in three important ways, the Court explained, in cases involving forum-selection clauses.

First, in balancing interests, the court may not consider “the plaintiff’s choice of forum,” because the plaintiff already agreed by contract that another forum is more appropriate. Although “plaintiffs are ordinarily allowed to select whatever forum they consider most advantageous,” when the parties have agreed in advance to a forum-selection clause, “the plaintiff has effectively exercised its ‘venue privilege’ before a dispute arises. Only that initial choice deserves deference.”

Second, because forum-selection clauses “waive” the parties’ “right to challenge the preselected forum as inconvenient,” the courts are limited to “consider[ing] arguments about public-interest factors only.” And the parties’ contractual choice of forum will outweigh public-interest factors “in all but the most exceptional cases.”

Finally, the court should apply the choice-of-law rules of the state in which the parties selected their forum, so that the plaintiff does not gain an unfair advantage by ignoring the forum-selection clause. Ordinarily, plaintiffs may affect the substantive law that applies to their case by choosing where to file suit, because a federal court typically applies “the choice-of-law rules of the State in which it sits.” Although the Supreme Court has recognized an exception for cases transferred because of convenience – under which the court applies the choice-of-law rules of the district where the plaintiff first filed suit – the Court rejected that approach in Atlantic Marine. The transferee court in the contractually selected forum will apply that forum’s choice-of-law rules as if the case had been filed there initially, in order to avoid privileging a party that “flouts its contractual obligation and files suit in a different forum.”

The Court also noted that the same revised analysis would apply regardless of whether the forum specified in the forum-selection clause is a federal, state, or foreign court. Because the federal transfer statute codifies the forum non conveniens doctrine, the Court explained, the statute and the doctrine function exactly the same way for these purposes, except that the remedy under the latter is dismissal (allowing the plaintiff to refile in a state or foreign court) rather than transfer.

The Supreme Court did not ultimately decide which forum was proper in Atlantic Marine, however. Instead, it rejected the lower courts’ balancing of public and private interests, because the private interests cannot weigh against enforcing the forum-selection clause, and remanded to allow the lower courts to consider in the first instance whether any public-interest factors preclude enforcement of the clause in this case.

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Canada’s new anti-spam laws (CASL), (S.C. 2010, c. 23), will come into force on July 1, 2014, and is the toughest anti-spam law in the world. Whether or not your client is located in Canada, CASL may affect your client. Even if your client isn’t a spammer, CASL will affect your client’s business operations in and from Canada.

Why should U.S. lawyers and their clients care about CASL? The answer is that CASL has considerable extra-territorial reach. CASL applies where “a computer system located in Canada is used to send or access” an electronic message. So, by way of example, CASL will apply if an e-mail is sent from the United States to a Canadian who receives and opens it on a computer located in Canada. In light of the long statutory reach outside of Canada and because of the unprecedented toughness of CASL, anyone involved in online commercial communications flowing into Canada needs to consider compliance with CASL.

A violation of CASL attracts significant administrative monetary penalties of up to $1 million for individuals and $10 million for others. Corporate directors and officers may be personally liable if they direct, authorize, or assent to, or acquiesce or participate in, a contravention of CASL, subject to a due diligence defense. Employers may be vicariously liable for violations of CASL by their employees, subject to a due diligence defense. It is also an offense under CASL to aid, induce, procure, or cause to be procured the doing of any acts contrary to certain sections of CASL, including the sections relating to CEM’s.

CASL regulates “commercial electronic messages” (CEM) which are defined broadly and includes any electronic message that has as its purpose, or as one of its purposes, the encouragement of participation in a commercial activity. An electronic message would include e-mail, text messages, and social media messaging and text, sound, voice, or image messages. Even if the electronic message itself is not related to a commercial activity, it may still be a CEM, having regard to the hyperlinks to other content or websites or the contact information contained in the message. Commercial activity is defined in CASL to mean any transaction, act, or conduct or any regular course of conduct that is of a commercial character, whether or not the person who carries it out does so with the expectation of profit. Common business activities, including sending e-mail messages to customers, operating a website, or making an application available for download, will therefore be subject to CASL.

CASL is fundamentally different than the U.S. Can-Spam Act of 2003, (15 U.S.C. ch. 103, Public Law No. 108-187, was S. 877 of the 108th United States Congress), because, unlike the Can-Spam Act, which is based on an “opt-out” model which assumes that recipients of unsolicited electronic messages have implicitly consented to their receipt until and unless they take steps to opt-out of the receipt of such messages, Canada is moving to an “opt-in” consent regime. This will prohibit the sending of CEM’s unless the recipient has given his or her express or implied consent, subject to limited exceptions. Problematically, a CEM cannot be used to request this consent which means companies will need to obtain express consent without using e-mail.

In addition to the obligation to obtain express or implicit consent to the sending of CEM’s, CASL also regulates the content and form of CEM’s. Every CEM must identify the sender, include prescribed contact information for the sender, and provide a specific unsubscribe mechanism which must permit the recipient to indicate, at no cost, that the recipient no longer wishes to receive CEM’s from the sender. The sender must comply with requests to unsubscribe to CEM’s “without delay,” and in any event within 10 business days. Prescribed contact information for each CEM includes the name and mailing address of the person sending the CEM, and a telephone number, e-mail address, or web address of the person sending the CEM. Where the CEM is being sent on behalf of another person, such as by a third-party service provider, the...
name of the third party as well as the name of the person on whose behalf the CEM is being sent must also be included.

CASL establishes a right of private civil action which may be commenced by any individual or organization affected by a contravention of CASL; however, this private right of action will not come into force until July 1, 2017. Class actions are also possible. These actions are of significant concern for anyone doing business in Canada or communicating online with Canadians. CASL also regulates the unsolicited installation of computer programs or software; however, these provisions will not come into force until January 15, 2015.

As a result of consultation with many different stakeholders, the three sets of regulations to CASL include many important exceptions that have to be assessed carefully by clients when implementing a compliance program. It is also important to consider Industry Canada’s Regulatory Impact Analysis Statement (RIAS) which clarifies questions raised during the consultation process, although the RIAS is not legally binding. Given the complexity and novelty of CASL, compliance with CASL will be complex and must be tailored for each client’s specific operations and processes.

The first phase of CASL’s implementation commences July 1, 2014, with the balance of its provisions being phased in over the following three-year period. U.S. lawyers and their clients will want to act quickly to assess whether the client needs to comply with CASL and if so, the process for compliance with CASL. Given the extremely high administrative monetary penalties, it is critical to act now.

Violet A. French is a partner at the Toronto, Canada, firm of Torkin Manes LLP.
Attorney: How can I help you?
Client: I am a 50 percent holder in a two-member LLC. Things were great at the beginning. Back then I got along really well with my partner. Now, we simply cannot agree on the future of the business. We cannot agree on any big decision.

Attorney: Does your agreement provide for a method to resolve a deadlock between the two of you?
Client: No.
Attorney: Well, does your agreement allow you to force the other member to buy your interest or permit you to force the other member to sell her interest to you?
Client: No. We never thought we would need something like that.
Attorney: In that case, one of the few options may be to seek judicial dissolution and the appointment of a liquidating trustee to wind-up the affairs of the business. Does your LLC agreement bar judicial dissolution?

Almost every attorney who regularly represents the members of Delaware limited liability companies (LLCs) has engaged in a variation of the conversation above. Pursuant to 6 Del. C. § 18-802 of the Delaware Limited Liability Company Act (LLC Act), “[o]n application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.” In the past, the Court of Chancery has generally exercised its ability to order judicial dissolution of an LLC in two situations: (1) when there is a deadlock between two 50 percent holders and the LLC agreement provides no method to resolve the deadlock and (2) where the defined purpose of the entity is either fulfilled or impossible to carry out. Enforcing the primacy of the freedom of contract as required by the LLC Act, the Court of Chancery in 2008 found that an LLC agreement may waive the statutory default right to seek judicial dissolution. However, in the recent decision of Huatuco v. Satellite Healthcare, 2013 WL 6460898 (Del. Ch. Dec. 9, 2013), the Court of Chancery carried this logic a step further, finding that a provision in the LLC agreement generally limiting the members’ rights to the rights expressly enumerated in the LLC agreement also served to waive Section 18-802’s right to seek judicial dissolution since the LLC agreement did not explicitly provide for such a right.

Prior to the Huatuco decision, the answer to the final question in the dialogue above was almost always “No.” In the wake of Huatuco, attorneys for clients seeking judicial dissolution must do more than confirm there is no provision expressly disavowing the right to judicial dissolution. They must examine the agreement to determine if there is broader language waiving or opting out of whole sets of default rights, including the right to seek judicial dissolution. Likewise, drafters of LLC agreements wishing to preserve members’ rights to seek judicial dissolution must do more than simply avoid a specific express waiver. If parties intend to use language limiting members’ rights to those expressed in the agreement (as opposed to default rights in the LLC Act where the agreement is silent), they should expressly provide the members the right to seek judicial dissolution unless the parties truly intend to waive that right.

LLC Agreement May Expressly Waive Right to Judicial Dissolution

The Delaware Court of Chancery first addressed the waiver of members’ right to seek judicial dissolution in R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008), which involved several LLCs owning land and race horses. The petitioners sought judicial dissolution, and the respondents opposed, arguing that the LLC agreements at issue expressly waived the members’ right to seek judicial dissolution. Emphasizing Delaware’s policy of freedom of contract in LLC agreements, then-Chancellor Chandler stated: “For Shakespeare, it may have been the play, but for a Delaware limited liability company, the contract’s the thing.” Each LLC agreement provided:

Waiver of Dissolution Rights. The Members agree that irreparable damage would
occur if any member should bring an action for judicial dissolution of the Company. Accordingly, each member accepts the provisions under this Agreement as such Member’s sole entitlement on Dissolution of the Company and waives and renounces such Member’s right to seek a court decree of dissolution or to seek the appointment by a court of a liquidator for the Company.

The court found this provision enforceable. First, then-Chanceller Chandler noted that 6 Del. C. § 18-1101(b) of the LLC Act “itself explicitly provides that ’[i]t is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.’” This freedom for members to structure an LLC differently than an entity governed primarily by statute, such as a corporation, including the ability to provide for different methods to resolve business relationship problems, is part of the allure of LLCs. Second, the court found that the right to seek dissolution is not among the few provisions of the LLC Act that may never be waived. For example, 6 Del. C. § 18-1101 expressly provides that “the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.” Section 18-802, by comparison, does not contain similar language. Accordingly, the court ruled that the LLC agreements at issue waived the members’ rights to seek judicial dissolution.

Identification of Non-Exclusive Methods of Dissolution Does Not Bar Judicial Dissolution

Although R&R Capital made clear that members of an LLC could waive judicial dissolution through an express waiver specifically referencing and disadvantaging such a right, it left open the question of whether something less than an express waiver would also abandon such a right. In Lola Cars Intern. Ltd. v. Krohn Racing, LLC, 2009 WL 4052681 (Del. Ch. Nov. 12, 2009), although one member owned 51 percent of the company and the other 49 percent, the LLC was managed by a board of directors and each member had the right to appoint one board member. The plaintiff sought judicial dissolution, among other reasons, because the board was deadlocked as to whether to replace the CEO. Additionally, the plaintiff pleaded that the current CEO’s failure to manage the business properly, along with the business’s poor performance, made it “not reasonably practicable” to continue the business.

Like many LLC agreements, the one at issue in Lola Cars contained a section addressing dissolution. The defendants moved to dismiss the request for judicial dissolution, arguing in part that the LLC agreement addressed dissolution and failed to expressly provide for judicial dissolution. In other words, the defendants interpreted Section 18-802 as a gap-filler that could only be invoked if the LLC agreement failed to address dissolution. Emphatically rejecting this argument, the Court of Chancery stated:

Assuming for current purposes that judicial dissolution under § 18-802 may be precluded contractually, the fact that this particular Operating Agreement merely contains several self-termination options and does not expressly provide for judicial dissolution does not make that statutory remedy unavailable. Each of the termination provisions contained in the Operating Agreement is permissive and may be triggered at a member’s election. Moreover, the Operating Agreement nowhere requires that a member terminate the Operating Agreement solely in accord with its stipulated termination provisions. Thus, the Court cannot conclude that these terms are exclusive. It simply cannot be true that a number of nonexclusive, permissive termination clauses in the Operating Agreement can preclude judicial dissolution as provided for in the Act.

Waiving Right to Judicial Dissolution if that Right is Not Enumerated

Reading R&R Capital and Lola Cars together, although the right to judicial dissolution could be waived, Delaware law required that LLC agreements must do more than provide for non-exclusive dissolution provisions to find such a waiver. However, the question remained whether parties to an LLC agreement could still waive the right to seek judicial dissolution by doing something less explicit than saying “the members waive the right to seek judicial dissolution.” Huatuco v. Satellite Healthcare answers that question in the affirmative.

In Huatuco, the defendant moved to dismiss the petition for dissolution, arguing that the LLC agreement waived all default rights under the LLC Act, including the right to seek judicial dissolution. Section 202 of the LLC agreement at issue provided:

The respective rights of each Member to share in the capital and assets of the LLC, either by way of distributions or upon liquidation, will be determined by reference to the Percentage Interest of such Member; and each Member’s interest in the profits and losses of the LLC shall be established as provided herein. Except as otherwise required by applicable law, the Members shall only have the power to exercise any and all rights expressly granted to the Members pursuant to the terms of this Agreement. No Member shall have any preemptive right to purchase or subscribe for additional Membership Interests in the LLC by reason of the admission of any new Member or the issuance of any new or additional Membership Interests or other debt or equity interests in the LLC.

In analyzing these provisions, Vice Chancellor Glasscock began by noting that the LLC Act “provides default provisions applicable to Delaware LLCs where the parties’ agreement is silent; where they have provided otherwise, with limited exceptions, such agreements will be honored by a reviewing court.” The plaintiff argued that Section 2.2 should not be read as a waiver of all default rights under the LLC Act, including the right to seek judicial dissolution, because the parties embedded the sentence italicized above in a section only dealing with the members’ economic
rights. In other words, if read in context, the opt-out did not apply to all default provisions of the LLC Act. Refusing to adopt plaintiff’s reading, the court explained:

While Section 2.2 addresses two kinds of economic rights – rights to distributions of assets upon liquidation, and preemptive rights – it also provides more generally that “the Members shall only have the power to exercise any and all rights expressly granted to the Members.” This statement is not qualified by reference to “economic” rights, but instead applies to “any and all” rights, that is, both economic and noneconomic, including a right – or lack thereof – to seek judicial dissolution.

Because the members opted out of all default rights, the court then was left to examine what rights to dissolution were left in the LLC agreement. Failing to enumerate judicial dissolution as a membership right, the dissolution section of the LLC agreement provided:

Section 8.1 Dissolution. The LLC shall be dissolved, its assets disposed of, and its affairs wound up, on the first to occur of the following: (i) the approval of a Super Majority-in-Interest of the Members to dissolve the LLC; (ii) the sale or other disposition of all or substantially all of the LLC’s assets and distribution to the Members of the net proceeds thereof; or (iii) upon the happening of any other event of dissolution specified in the Certificate of Formation or this Agreement. The defendants argued that the second sentence of the above-quoted language barred the plaintiff from seeking judicial dissolution.

Because Section 8.1 did not provide for a right to seek judicial dissolution, the court determined that “the members have effectively opted out of the statutory default contained in 6 Del. C. § 18-802.”

Conclusion
In the past, when irreconcilable disagreements arose between LLC members and the LLC agreement did not provide for a method to resolve the dispute, judicial dissolution under Section 18-802 became a rational alternative. However, given the Huatuco ruling, deadlocked members of LLCs must now carefully examine the LLC agreement to determine if the parties waived all default rights, including the default right to seek judicial dissolution. Unfortunately, when two partners engage in a “business marriage” by creating an LLC to carry out some joint undertaking, they often are much more focused on the formation of marriage rather than any potential disagreements or a “business divorce” if a serious disagreement cannot be resolved. This is not surprising. The LLC agreement is drafted at a time when the members want to be in business together, and have a meeting of the minds as to how to run that business. Furthermore, in order to avoid certain default rights, such as default traditional fiduciary duties, some LLC agreements adopted during this honeymoon period contain broad waiver language such as was the case in Huatuco. If parties do have such broad waiver language, in the wake of Huatuco, one step parties may want to take now is to reexamine their respective LLC agreements and consider whether they truly intended to waive the members’ right to seek judicial dissolution, and amend the LLC agreement if they did not.

If judicial dissolution has been waived, either expressly as in R&R Capital or pursuant to a more general opt-out provision as in Huatuco, in the event of a deadlock, the parties must seek a more creative solution. First, one member could attempt to buy out the other. However, in such a situation, the seller would likely use the other party’s inability to seek judicial dissolution as a method to extract a premium. Second, part of the reason the R&R Capital court felt comfortable in finding that the right to judicial dissolution could be waived was because the implied covenant of good faith and fair dealing could not be waived. Accordingly, because of the implied contractual covenant, then-Chancellor Chandler wrote that “[t]here is no threat to equity in allowing members to waive their right to seek dissolution, because there is no chance that some members will be trapped in a limited liability company at the mercy of others acting unfairly and in bad faith.” Unfortunately, the court did not further explain how the implied covenant could be used in practice to remedy the waiver of judicial dissolution. Finally, in Huatuco, in a footnote, the court left open the possibility of judicial dissolution even in the face of a waiver under the right circumstances. According to the court:

Whether the parties may, by contract, divest this Court of its authority to order a dissolution in all circumstances, even where it appears manifest that equity so requires – leaving, for instance, irreconcilable members locked away together forever like some alternative entity version of Sartre’s Huis Clos – is an issue I need not resolve in this Memorandum Opinion. As I find below, considerations fundamental to equity are absent here.

Significantly, the petitioner in Huatuco filed a notice of appeal on January 7, 2014, so practitioners should continue to monitor developments in this case.

Jason C. Jowers is a partner at Morris James LLP in Wilmington, Delaware, where he practices in the areas of corporate, alternative entity, and complex commercial litigation.
Susan is the general counsel of a mid-size corporation – we’ll unimaginatively call it Acme – that operates through several subsidiaries. She has a centralized legal department, which usually handles all of the legal work for all Acme entities. For a number of tax and business reasons, there is in place a “tax sharing agreement” between Acme and each of its subsidiaries; in essence, the agreements provide that each year the subsidiary makes a tax-equivalent payment to Acme based on the taxes that would have been payable if it were a stand-alone company, with appropriate provisions for the treatment of losses, etc.

In a desire to focus on its core businesses, Acme management decides to sell the Beta subsidiary and LargeCo acquires it; as is customary, that work, too, was handled by the law department, with some minor assistance from outside counsel. A year after the closing, a question arises causing LargeCo to believe that Beta’s tax-equivalent payments to Acme in prior years were excessive. Unable to settle the matter, LargeCo causes Beta, now its subsidiary, to sue Acme.

What is Susan’s Role in the Litigation as Acme’s General Counsel?

The answer provided by the ethics rules of the various states is simple: None, except possibly as a witness, called by LargeCo. When Susan’s prior client, Beta, sues her current client, Acme, and her law department was involved in representing the former client with respect to the subject matter (all clearly true here), Model Rule 1.9(a) could not be more clear:

A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s interests are materially adverse. . . .

Indeed, note that this disqualification does not simply attach when litigation is filed. When LargeCo first notified Acme of the concern, and the Acme CEO called Susan, her response should have been that she couldn’t advise on that topic. An exception is available for informed written consent (more about that later), but the likelihood is that LargeCo’s subsidiary, Beta, will not consent once the dispute has surfaced. Necessarilly, the same result would obtain if the dispute were triggered by the acquisition agreement rather than the earlier tax-sharing agreement.

While this result may surprise many in-house lawyers, the conclusions are generally inescapable, although there is some degree of ambiguity as to what precisely this means for the modern general counsel, who wears a number of hats within the corporate enterprise. She is advisor on things legal, to be sure, but she is much more than that. She participates in many aspects of management, including risk evaluation, personnel review, oversight of at least some parts of the audit function, etc. Which of these activities is foreclosed by her disqualification? One would think that the disability extends only to those things that would constitute “representation” of Acme with respect to a relevant subject, but the line is unclear.

The extremes may be easily set out. Susan may look at Acme’s other tax-sharing agreements with subsidiaries to see whether they ought to be amended in view of the issues raised in the Beta litigation. (A theoretical argument could be made for separate representation of the subsidiary – and there may be situations in which that is a useful approach – but the uniform view is that a parent and its wholly-owned subsidiaries may be represented by the same counsel. At least that question is resolved in the expected manner.) Susan may not, however, go into the courtroom and argue a motion in the case. She may not participate in formulating litigation strategy in the case, and she probably shouldn’t participate in a meeting between management and outside counsel regarding the case. Nor should she be involved in explaining the background of the case to the outside counsel chosen to represent Acme without being very careful to limit the nature of that discussion. As to the latter points, the problem isn’t that she can’t tell outside counsel what she knows – as discussed below, she may well be a witness, and anything she could testify to in court, she could obviously tell counsel. The problem is that the discussion may easily slide into a discussion of Acme’s litigation strategy, and since she can’t represent Acme, anything told to her probably is outside of the privilege. And lest one think

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otherwise, the other lawyers in the legal department are subject to the same infirmity – Model Rule 1.10 imputes the disqualification of one lawyer to all other lawyers in a law firm, and Model Rule 1.0(c) is clear that a corporate legal department is the equivalent of a law firm, although there may be some variations among different jurisdictions on some of these issues. (Explaining all of this to Susan’s CEO may not be easy, unless the CEO happens to be a lawyer by training – particularly if the matter involves a material exposure to the company – but that can’t change the conclusions.)

As a Witness?
Unfortunately, disqualification from advising with respect to the dispute does not end the matter. Susan, or others in her law department, are likely to have detailed knowledge of factors relevant to the dispute, particularly when it involves an agreement that they prepared.

In this situation, the law department’s representation of Acme and Beta is likely viewed as a joint representation, with the consequence that either of the joint clients may waive the privilege otherwise attaching to any communications. So, yes, Susan may well be called as a witness, and compelled to testify about communications with Acme’s management relevant to the dispute.

In any given situation, of course, resolution of the issues involving which entity is a “client” of the office of the parent’s general counsel entitled to assert the privilege, and with the right to waive it, will be fact-specific, but it is clear that some general counsels have sometimes been surprised by the answers.

Conclusion
Most of us don’t think much in advance about what happens when the parent–subsidiary relationship changes, but the consequences can be very significant. The complicated litigation that culminated in the Third Circuit’s decision in Teleglobe, (In re Teleglobe Communications Corp., 493 F.3d 345 (3d Cir. 2007)), is only one of the more noteworthy exemplars. Fortunately, there is at least a possible solution, alluded to earlier: Model Rule 1.9(a) also provides that its restrictions apply “unless the former client gives informed consent, confirmed in writing.” While there has long been debate about the requirements for “informed consent,” in a corporate setting of this sort it should be possible to satisfy most requirements. One could, of course, establish subsidiaries with separate law departments and treat them in a completely arms-length fashion, but while that would solve the conflict problem, it would probably sacrifice too much authority – for both the general counsel and the parent entity – to be satisfactory.

In appropriate cases, and certainly when a subsidiary – or a minority interest – is being sold, it would clearly be good practice to reduce to a signed writing the expectations of the parties regarding matters of privilege and subsequent representation. Absent such a written waiver, if a dispute arises, the law department is in a very uncomfortable position.

Simon M. Lorne is vice chairman and chief legal officer of Millennium Management LLC, a New-York based alternative asset manager.

A Message from the Professional Responsibility Committee
Creating a Network of State and Local Bar Ethics Committee Liaisons
The Professional Responsibility Committee intends to create a network of State and Local Bar Ethics Committee Liaisons, charged to bring to the attention of the Committee significant ethics opinions, disciplinary rulings, judicial opinions, statutory developments, and changes in rules of professional conduct in their respective jurisdictions. The Committee has volunteers to serve as Liaisons for Colorado, New Jersey, Oregon, and Texas. If you would be willing to serve as a Liaison or if you would be interested in taking a broader leadership role in this initiative please contact the Committee Chair, Charlie McCallum, at cmccallum@wnj.com.

ADDITIONAL RESOURCES
For other materials related to this topic, please refer to the following.

John Villa, Corporate Counsel Guidelines (1999, updated annually), a joint project of Thomson Reuters and the Association of Corporate Counsel (ACC).
Member Spotlight:  
Alvin W. Thompson

Before being appointed a U.S. District Judge for the District of Connecticut in 1994 by President Clinton, Alvin W. Thompson served for three years as the managing partner of Robinson & Cole. In that role, he was the first African-American to lead a large Connecticut law firm. In his practice there, he represented regional banking companies, special finance companies, state government entities, and privately held companies in financial matters. In his earlier years at the firm, he also had a secondary practice of immigration, representing businesses needing to obtain nonimmigrant or immigrant status for employees.

A former chair of the ABA’s Business Law Section (2005–2006), Thompson has worn many hats in the Section. Among other things, from 1991 until 1995, he was co-chair of the predecessor to the Section’s Committee on Diversity; he served on the Section Council for four years and served as an officer of the Section for five years beginning in 2002; and he has co-chaired the Committee on Business Law Fellows, Ambassadors and Diplomats, and the Leadership Development Committee. His current home in the Section is the Committee on Business and Corporate Litigation. Thompson has also served the ABA in various capacities outside the Business Law Section, including serving on the Legal Opportunity Scholarship Committee, the Committee on Disaster Response and Preparedness, and the ABA Commission on the American Jury.

Devoted to public service, Judge Thompson has over the years served on the boards of numerous civic and charitable organizations – his longest standing involvement is with the Salvation Army, where he has been a member of the local Advisory Board since 1979. A 1975 graduate of Princeton University and 1978 graduate of Yale Law School, he received the 2008 Edwin Archer Randolph Diversity Award from the Lawyers Collaborative for Diversity, a non-profit committed to advancing the professional status of attorneys of color and women in law firms throughout Connecticut and Massachusetts.

What inspired you to attend law school and practice law?

I didn’t grow up knowing any lawyers except the lawyer who interviewed me for college. When I went to college I was really interested in architecture. I also had a very strong interest in history and wound up majoring in history, and I got a certificate in Afro-American Studies, as it was called at the time. One of the professors brought in as guests some friends that he’d had from college who had all gone to law school. One of them was an in-house lawyer, one was a civil rights litigator, and one was getting a Ph.D. in philosophy. I saw these people who’d all gone to law school together and they were fascinating people. They were all doing very different things. So it seemed to me that the law was something that offered a great variety of opportunities and it was something that was very interesting as well. So I went to law school feeling fairly confident that when I graduated I would find a number of things I’d be interested in doing, and that turned out to be the case.

What was it like to be one of the first attorneys of color admitted to the Connecticut bar?

When I became a partner in Robinson & Cole, I think there had been one African-American partner at my firm who left to go into the state legislature just before I got there. And there were two others in other large firms in Connecticut. So there weren’t a lot of lawyers of color and certainly not people who were partners in the large firms.

But I was used to being in a very distinct minority. In high school, I was fortunate enough to get a scholarship to a private high school. They had five kids from inner-city Baltimore who were given scholarships to come, and four of us were African-American. So it was not something I was unused to. I had developed some ways to feel comfortable and I figured how to read situations.

The fact that I was at the particular firm I was at was also very helpful. The people were wonderful. I’m still very close with all of them today. I felt very supported. And I learned over time that there had been a lot of firsts in terms of the legal profes-
sion becoming more diverse. I learned stories of the people who’d been the first Catholic hired at a particular firm, or the first Jew hired at a firm, or the first person from a non-Ivy League law school. I was much more conscious of an obligation to continue the evolution in terms of the legal profession being a profession that affords opportunities to everyone, no matter what their origins and beginnings.

Why did you specialize in finance?

In my first couple of years, I did litigation more than anything else, which as it turns out has benefited me in the long run. I also continued to do litigation work on pro bono matters after I started to do mostly finance work. I also did immigration work because the person who was doing it didn’t want to do it, and it was an interesting little side line and turned out to be quite lucrative. I wound up doing a lot of finance work, because in my class and the classes on either side of me, there weren’t many people who wanted to do corporate or finance work. So I sort of wound up doing some.

It was fascinating. I enjoyed it immensely. I enjoyed litigation work immensely. So I think because I was willing to do it that I wound up getting a lot of it. But it wasn’t that I really picked it out, because I always wanted to do that kind of work.

My general experience has been that every kind of matter I’ve worked on somehow comes back to benefit me. Because the law is really about legal principles and people and, in the long run, things that don’t seem connected to something you’re doing a few years later will, in a way that you least expect it, give you some insight into an approach to dealing with a person or solving a legal problem.

What were the highlights of serving as managing partner of your firm?

I felt incredibly honored to be elected, especially at such a young age, by a group of people for whom I had such respect and who I liked so much. Our firm was a very democratic partnership and I really liked working to build consensus.

I’m very systems oriented and I think for me one of the highlights was making law firm governance and operations more systematic. I also spent a lot of time getting the firm’s Boston office up and going and that was very satisfying.

In terms of being African-American, I appreciated the symbolic significance of it. Personally, to me, it wasn’t a real big deal. But I understand it was an important statement about the progress of the profession.

What did you like most and least about practicing law?

First, it was intellectually stimulating. I still get that today, of course. I liked that I was helping people with their problems. Even when I was dealing with an institutional client, I was really dealing with a particular loan officer and they had a problem that they needed help with.

I liked the fact that at times I would be teaching the client. At times I would be working collaboratively with the client to come up with a creative solution, or I would provide the legal input and analysis and the client would make the business decision. I liked empowering the client to make an informed business decision.

The least enjoyable aspect of private practice for me was probably business development. I like meeting people. I like to develop relationships with people, but I really enjoy it more if I’m developing the relationship because I just want to have a relationship with them as opposed to developing relationship with – in the back of my mind – hoping that this will turn out to be a source of work for the firm. The best case scenario is you develop a relationship with someone and it turns out to be a source of work for the firm. But that probably doesn’t happen as much as it used to.

What do you find the most gratifying part of being a judge and the most challenging part?

I guess both gratifying and challenging is the fact that I deal with such a great variety of cases. I can go from dealing with a very technical matter under the sentencing guidelines to working on something on a securities class action to working on a patient case all within a matter of 30 minutes, because different law clerks circle through or I’m in court. That’s very intellectually stimulating. But it’s challenging to set aside that block of time sometimes when you want to just focus and dig in.

I feel a great sense of satisfaction when I can look back on something I’ve done and – it may sound odd – realize that the decision I’ve made was the one that the law and the evidence led to, but if I had my own personal preference, I would have come out the opposite way. And the reason that’s gratifying to me is I’ve been entrusted a great responsibility to be fair and impartial and to put my personal views and preferences to the side. I think that’s sometimes very hard for people to do in any number of roles. And nobody knows whether I’ve done that except me.

It’s sort of like in high school: we had an honor code. I’m really operating on an honor system in that respect and I take a great deal of satisfaction out of knowing I’ve done the things the right way and I’ve lived up to the oath I took. I have particular cases I can think of where if I had written the laws I would have rewritten it to cover this person. And I didn’t.

In terms of challenges, it’s sort of related, but as a federal trial judge I make decisions that really affect people’s lives. A lot of times you are really making judgments about people. And in making judgments about people it’s very important to identify any areas where you have a bias and it’s not always easy to do. Because probably, the deepest biases [are those that] you’re the most unaware of, unless you’ve had some experience in the past that’s helped you identify them.

You have been deeply involved in your church community, including serving as a church school teacher. How has that influenced you?

My experience in my congregation has been one that has constantly energized me and helps me direct my thoughts about how to be a better person and what my relationship with others around me should be. That
is very consistent with my natural desires and instincts. I worked with the youth for a while. I’ve been on just about every committee that you can be on – the business ones, social action, social outreach committees. I sometimes help lead our adult class discussions and we’ve done some really challenging books. They’re intellectually challenging and stimulating. I enjoy that stimulation and I find there’s a cross-fertilization, because the kinds of things that you’re thinking about in one area do stimulate your thinking in others. For me, dealing with the Constitution and dealing with the Bible, I do find I have parallel approaches to them.

One of the things that I benefit from is we serve coffee to the homeless on the front steps of the church on Sunday morning. I started out doing that because I thought I would be doing something for them as I served a hot drink to them on a cold winter morning. But I think I learned that I got more out of it than I was giving them – I really learned to see people I otherwise didn’t relate to very much, if at all, more as whole people. I felt more like I was in a neighborhood than I did when we simply walked in to worship on Sunday and didn’t interact with the people who were sitting on the benches in the grassy area next door. That’s carried over to how I approach my work. This expands my group of close friends to people who are come from a wide variety of backgrounds, some of whom have been homeless in the past. I find that has really enriched my life.

What have been the highlights of your work with the ABA Business Law Section?

I went to my first meeting in 1985, and I came away really sold on the value of the meetings. I found that people had very serious in-depth discussions about legal issues. Attending those kinds of sessions as well as the programs really increased my level of understanding of the law, the sophistication of my thinking, and gave me practical tidbits I took back to use in my practice.

I was on the editorial board for Business Law Today, which I enjoyed immensely. Being the editor of the Business Lawyer and being on the board of Business Law Today were both intellectually enriching because you just found yourself getting all these articles written in areas about which you know very little, and at the end you have an understanding and some appreciation for an area of law about which you had no familiarity beforehand. I also served as co-chair of the Leadership Development Committee, which dovetailed with my interests in systems and how organizations work.

Overall, I just have to say that my involvement with the Section has been rewarding in terms of the personal relationships I’ve developed with a good number of people through my association with the Section. It’s been rewarding in terms of enhancing my practice and deepening my understanding of the law.

In my present position, going to meetings allows me to see people who are litigators who are very interested in improving the law and very dedicated to the ideals of the profession. Because when they’re in court, in the courtroom, that’s not what they’re there for. It’s always helpful for me to have a reminder that there are a good number of those kinds of lawyers out there who are committed to the ideals of the profession and improving the law, even though they may not be the ones I saw in the courtroom yesterday.

What is a commonality among the most successful business lawyers that you know?

They get excited about working with the law. They care about having laws that are fair and balanced. And there’s an appropriate accommodation of competing interests. They understand what you’re trying to accomplish with the law and they’re therefore able to use it effectively for their clients. They have good people skills. They like people and they know how to work with people. They try to understand people. And finally, they care about the profession as a profession.

There’s a part of the Rules of Professional Conduct that says the lawyer is a representative of clients, an officer of the legal system, and a public citizen having a special responsibility for the quality of justice. The most successful lawyers hit all three of those.
The Business Law Section held its 2013 Fall Meeting on November 22 and 23 in Washington, D.C. The meeting featured 12 CLE programs and numerous additional meetings, roundtable discussions, and dinners. The materials from and recordings of those CLE programs are all available through the Business Law Section website. In December, we highlighted half of the programs from the Fall Meeting. Here are the rest of the CLE’s from that meeting:

**A Practitioner’s Guide to Trends in True Sale and Other Structured Finance Opinions**

The Law and Accounting, Legal Opinions, Federal Regulation of Securities, and Securitization and Structured Finance Committees collaborated to present “A Practitioner’s Guide to Trends in True Sale and Other Structured Finance Opinions.” Carolyn P. Richter moderated the panel, which included Mark J. Friedman, Thomas E. Plank, and Steven O. Weise. The panel discussed potential deal structures, the risks of forward solvency guarantees, factors used to determine whether a transfer is a true sale, relevant Dodd Frank considerations, and how the analysis of whether a true sale occurred shifts when the seller is a bank.

**A Profession If You Can Keep It: Challenges to the Practice of Law and Professional Ethics**

The Professional Responsibility Committee presented an ethics discussion moderated by Charles E. McCallum, “A Profession If You Can Keep It: Challenges to the Practice of Law and Professional Ethics” (audio). Panelists Stephen Gillers and Doreene Keemer Damon addressed the ways in which technology and globalization are changing the business of law. First, Mr. Gillers discussed the historically localized nature of the practice of law before 1965, the ways in which that has changed due to technology, specialization, and globalization, and how it is expected to change over the next 20 years. Then, Ms. Damon commented on Mr. Gillers’ discussion and highlighted the questions raised by Mr. Gillers’ observations.


The Legal Opinions Committee presented “On the Cutting Edge: Discussion of TriBar’s New Choice of Law Report and the Impact of Opinion Practice of the SEC’s New Regulation D Rules” (audio). Robert Buckholz and Timothy G. Hoxie moderated the panel consisting of Donald Glazer and Stanley Keller. The panelists discussed two recent developments relevant to opinions practice: the recent TriBar report on Choice of Law Opinions and the SEC’s new Regulation D rules pertaining to general solicitation and “bad actors.” The panel also discussed how these developments related to the scope, meaning, and diligence in connection with no-registration opinions.

**Pay Ratio Disclosures and Other Hot Proxy Topics**

The Employee Benefits and Executive Compensation Committee and the Federal Regulation of Securities Committee presented “Pay Ratio Disclosures and Other Hot Proxy Topics” (audio), which discussed the SEC’s impending disclosure rules concerning executive compensation and executive pay ratio disclosures and steps that companies may take in response in the upcoming proxy season. Martha N. Steinman moderated the panel, which included Mark Borges, Susan J. Daley, Howard Dicker, and Christina Padden.

**Regulatory and Enforcement Trends and Developments Affecting Investment Advisers, Investment Companies and Private Funds**

Andrew J. Donohue and Paul N. Roth co-chaired a panel consisting of Andrew J. Bowden, David Grim, Anthony S. Kelly, and Lori A. Martin, discussing the “Regulatory and Enforcement Trends and Developments Affecting Investment Advisers.”
Investment Companies and Private Funds” (audio). The Federal Regulation of Securities Committee presented the panel. The panel provided an overview of No Action Letters, Division of Investment Management Guidance Updates, Investment Company Act and Investment Advisers Act enforcement cases, relevant speeches, relevant studies, and proposed and adopted rules from 2013. The panel also touched upon recent communications from the Office of Compliance, Inspections and Examinations, selected SEC press releases, and Investment Advisers Act Notices and Orders from 2013.

What the Supreme Court’s Decision in U.S. v. Windsor Means for Corporate Diversity and Inclusion

The Employee Benefits and Executive Compensation Committee presented “What the Supreme Court’s Decision in U.S. v. Windsor Means for Corporate Diversity and Inclusion,” a discussion of how the U.S. Supreme Court’s decision in U.S. v. Windsor, striking down as unconstitutional Section 3 of the Defense of Marriage Act of 1996 (DOMA), affects the efforts that a corporation must make with respect to diversity, inclusion, and most specifically, employee benefits. Joseph M. Manicki moderated the panel, which included Kendall Daines and Phillip Long as panelists.
# Business Law Today Board Members 2013–2014

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