BUSINESS LAW TODAY

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Feature Articles

- **A New Look At Fraudulent Transfer Liability In High Risk Transactions**
  Recent cases (most importantly, a 2016 circuit-splitting decision by the Seventh Circuit) may signal that the pendulum is swinging away from the historical difficulty in recovering constructive fraudulent transfers in connection with failed LBOs and leveraged recaps; as well as raising ethical, discovery, and dischargeability issues in connection with "actual intent" fraudulent transfers. This article explores these cases and the history and policy considerations that led to them.
- **Sustainability Meets Integrity**
  "Business sustainability" has become an important addition to board/management discussions in recent years. "Business sustainability" focuses on a company's ability to conduct its activities and build shareholder value over the long term, balancing the need for short-term results while adapting business strategies and operations to assure long-term value creation consistent with sustainable business practices. Inherent in meeting these challenges, companies are required by law to maintain a culture that embraces ethical values and legal compliance.
- **Buying Assets in Bankruptcy: Has the Second Circuit Taken the Wind Out of Sales Free and Clear?**
  This article reviews the Second Circuit's decision in the General Motors case and the propriety of a "free and clear" sale order with respect to claims held by parties who did not receive actual notice of the bankruptcy sale. In the underlying decision of the Bankruptcy Court, Judge Gerber determined that although certain claimants did not receive actual notice of the sale, their arguments were similar to parties who had filed objections to the sale, which were overruled. He found, therefore, that those claimants were not prejudiced by the lack of notice. The Second Circuit determined otherwise, and held that such claimants, having been denied any seat at the table, were prejudiced by the lack of notice and consequently, the sale to "New GM" could not be free and clear of such claims.
- **Top 10 Things Every Business Lawyer Should Know about Bankruptcy**
  Every business lawyer needs a basic understanding of bankruptcy law. Your client can be affected by a bankruptcy in many ways: it may be a creditor in a bankruptcy case; it may need or want to do business with a trustee or debtor in a bankruptcy case; or it may be a defendant in a preference action or other bankruptcy litigation, among other possible scenarios. Your client also may face financial distress and need to explore

restructuring or wind-down options, including filing for bankruptcy. A business lawyer needs to understand the basics to address common bankruptcy issues that arise in business matters.

- **The Interplay between Corporate Governance Issues and Litigation: What Is Corporate Governance and How Does It Affect Litigation?**
  This article explains what is encompassed by the term "corporate governance" and discusses how plaintiff and defendant positions in litigation can be affected by an organization's governance structures, processes and business conduct. Three cases are presented illustrating the determination of liability, causation, and damages in complex commercial litigation and in a Securities Fraud Action and the impact that corporate governance issues and knowledge had on the outcome.
- **Entity Lifecycles: An Overview of the Statutory Requirements Relating to the Formation, Maintenance, and Termination of Delaware Corporations, Limited Liability Companies, and Statutory Trusts**
  Selection of a business entity is one of the most fundamental and important decisions a business lawyer and her client can make. Delaware is generally recognized as the premier jurisdiction for business formation, and offers a variety of entities, each with different characteristics, which may be formed to meet the needs of the enterprise and to organize the relationship among owners, creditors, and management. Therefore, it is imperative to the selection process that all parties involved possess a basic understanding regarding the lifecycles of the most common Delaware business entities. This article provides a brief overview of the fundamental requirements relating to the formation, maintenance, and termination of Delaware corporations, limited liability companies, and statutory trusts.
- **Website Accessibility for Persons with Disabilities: The Why & How**
  Despite one in five Americans having a disability, website owners and developers neglect to make their websites accessible to persons with disabilities. The courts are split as to whether websites are places of public accommodation and if they need to be accessible. The preferred standard for accessibility is WCAG 2.0, a standard developed by the World Wide Web Consortium, which provides that websites must be perceivable, operable, understandable, and robust. This article discusses current legal posture of website accessibility requirements and an overview of the WCAG 2.0 guidelines to make your clients' websites accessible.
- **What Non-Californians Need to Know about California Taxes**
  Taxes can be a major factor in business and personal decisions. And it is only natural to think primarily about federal taxes. But state taxes can be big too, and few are bigger than California's. Surprisingly, even if you are not a resident of California, you may have reason to deal with California's tax agencies. California's tax rules are complex, and California's taxing agencies are notoriously strict when it comes to enforcement. The exposure can be surprisingly big and surprisingly long, as this dive into California taxes for non-Californians makes clear.
- **Threats to the SEC's Independence**
  At the November Business Law Section meeting, former SEC Commissioner Roberta

Karmel was the keynote at the Securities Committee Luncheon, and delivered the following remarks about the need to preserve the independence of the SEC.

- **2016 Revision to Model Business Corporation Act Makes Its Debut**
  Business Law Section's Corporate Laws Committee is publishing this month the first complete revision to the Model Business Corporation Act since 1984. Dozens of members from Corporate Laws have worked on this seminal book and it is considered one of the most respected books published by the ABA.

Departments

- **KEEPING CURRENT: HR Professionals Beware: Antitrust Violations in the Employment Arena May Subject Employers and their HR Personnel to Criminal Prosecution**
  The Antitrust Division of the Department of Justice and the Federal Trade Commission recently announced a policy shift in their enforcement priorities related to agreements among competing employers. Specifically, the agencies expressed the DOJ's intent to criminally prosecute employers and individuals who enter into naked wage-fixing or no-poaching agreements with other employers. As a result of this announcement, all companies that compete for employees should review their compliance programs.
- **DELAWARE INSIDER: Don't Let the Name Fool You: Delaware Statutory Trusts are Controlled by Contract**
  In Grand Acquisition, LLC v. Passco Indian Springs DST, the Delaware Court of Chancery was presented with a rare opportunity to address the contractual freedom granted to parties under the DSTA. This article discusses the policy of maximum freedom of contract shared by the DSTA, the Delaware Limited Liability Company Act, and the Delaware Revised Uniform Limited Partnership Act. It also examines the Court of Chancery's decision in Grand Acquisition and provides several key takeaways.
- **MEMBER SPOTLIGHT: An Interview with Justice Henry duPont Ridgely**
  After more than 30 years of service as a jurist in the Delaware Judiciary, Justice Henry duPont Ridgely is a walking library of Delaware business law decisions. During his tenure on the Supreme Court of Delaware, he participated in more than 700 published opinions. During his leadership of the Delaware Superior Court, Delaware was first recognized by the U.S. Chamber of Commerce as first among the 50 states for the fairness and reasonableness of its litigation environment. Delaware is still number one today. Now he is Senior Counsel at DLA Piper in Wilmington, Delaware, and a Business Law Advisor to the Business Law Section.
- **INSIDE BUSINESS LAW**
  In this issue of "Inside Business Law," we provide links to register for several upcoming stand-alone committee meetings that will be held in January as well as the Section Spring Meeting that will be held in New Orleans in April.

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BUSINESS LAW TODAY

A New Look At Fraudulent Transfer Liability In High Risk Transactions

By Jonathan M. Landers and Sandra A. Riemer

Overheard, *in late 2015*, at a very upscale restaurant in New York City:

Hedgie Funde: We have this great LBO opportunity . . . should make four or five times our money in two or three years! But some of my guys are freaked out about legal risk.

John Bull: Not to worry. Worst case, it will cost you a few bucks for lawyers, other pros, and creditors, but it shouldn't be much.

Hedgie: But all that litigation . . . seems to go on forever! Looks like a feeding frenzy by lawyers and their friends. And, look at cases like *Energy Transfer* and *Caesars*.

John: Has nothing to do with your situation. In both cases, there was lots of greed and a short-circuiting of orderly process. You know the old saying—pigs get fat and hogs get slaughtered.

Hedgie: Seems to me like all the litigation starts with big numbers and lots of noise.

John: It does, but things calm down. Look, I'll explain it in simple terms. You stand to make 400 percent in two years. You don't do that in two years without some risk. Instead, you do it mostly with other people's money—you borrow money to pay off the stockholders, use the assets of the company as collateral, put up a few bucks of your own to show good faith, and run the business for a couple of years; and then, you sell out most of your investment. The banks are dying to make these loans.

Hedgie: But, what if we don't make it and a bankruptcy is filed? Won't lots of folks come after us, and won't the judge do something for creditors?

John: Here's the good part. The courts don't like this kind of litigation, and lots of cases support the folks who did the deal. The chance you'll have to pay lots of money is very small, and the risks go down if the company makes it for at least two years. Of course, you've really got to have your ducks in a row when you do the deal, and get lots of expert opinions. You've got to have lawyers who know how to play the game; and you've got to have a team fully prepared to go if the worst happens. Real world risk in dollars is lots less than the upside. But, your pros have to be the best.

Hedgie: And, I assume that means you.

John: C'est la vie.

* * *

This article explores the history that led to that conversation, and whether anything has changed in the year since that conversation took place.

Leveraged buyouts (LBOs) and leveraged recaps (LRs) are high risk transactions for a business (i.e., the target) and its creditors. The LBO adds debt to the target to facilitate the purchase of its shares; and the LR adds debt to make distributions (i.e., pay dividends) to existing shareholders. As a result, the target's debt is increased, usually significantly, resulting in greater leverage; potential cash flow and solvency issues; and, ultimately, a much larger risk of default, insolvency and liquidation. And, despite a few contrary feints by supporters of these deals (asserting supposed synergies with related entities, better management, and other intangible benefits), there is little or no quantifiable benefit to existing or future creditors;

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and the LBO or LR, essentially, transfers value to shareholders and increases the risk of nonpayment to creditors. As the Third Circuit noted in 1991:

> [t]he effect of an LBO is that a corporation's shareholders are replaced by secured creditors. Put simply, stockholders' equity is supplemented by debt. The level of risk facing the newly structured corporation rises significantly due to the increased debt to equity. The added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of insolvency. . . . The target . . . receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation.

Mellon Bank, N.A. v. Metro Communications, Inc., 945 F2d 635, 645-46 (3d Cir. 1991), cert. denied, 503 U.S. 937 (1992).

If there is a bankruptcy, the validity of such transactions will be tested by federal and state statutes governing fraudulent and avoidable transactions, most importantly sections 544 (which incorporates state fraudulent transfer laws) and 548 of the Bankruptcy Code. These statutes have two objectives: before the transaction, they provide guidance as to what transactions might be avoidable and the potential liabilities of involved parties (arguably, discouraging questionable transactions); and, after a transaction that leads to insolvency and/or bankruptcy, they provide for recoveries by injured creditors and the debtor-in-possession/trustee in bankruptcy. Obviously, as the dialogue above suggests, both effects depend substantially on the likelihood of real world consequences for parties to the transactions.

In the past decade or so, the deterrent effect has significantly weakened as a result of various statutes and court decisions that have provided new defenses and interpreted laws governing fraudulent and avoidable transfers narrowly and defenses broadly. This weakening of remedies, together with what appeared to be some judicial hostility to such litigation (resulting, in part, from the proliferation of quick section 363 sales in lieu of a plan process, the perception that out-of-the-money creditors used litigation to gain leverage and a "tip," the dramatic increase in the cost of litigation resulting from widespread e-discovery and stiffened pleading rules, and the increased involvement of unsympathetic hedge funds and claims traders on all sides) has led to a proliferation of transactions which are close to the line. The end result of these trends may be best illustrated by the report of the *Caesars* Examiner which describes the use of a multitude of techniques in an effort to protect what he found to be numerous probable or likely fraudulent transfers. (See *In re Caesars Entertainment Operating Company, Inc., et al.*, United States Bankruptcy Court for the Northern District of Illinois, Eastern Division, Chapter 11 Case No. 15-01145 (ABG), Docket No. 3720.)

The discussion will proceed in two parts. The first examines various statutes and decisions that undermined effective remedies. The second examines several recent decisions that may signal a turn in the road.

The Demise of Remedies

Defining Away Constructive Fraudulent Transfers

A constructive fraudulent transfer requires that the debtor receive "less than a reasonably equivalent value" for the transfer of an asset or the incurrence of an obligation, and (1) be insolvent at the time of, or be rendered insolvent by, the transfer or the incurrence of the obligation, (2) be engaged or about to engage in a business or transaction for which the remaining property constitutes "unreasonably small capital," or (3) intend or believe that it would incur debts which would be beyond its ability to pay as such debts matured. In most LBO/LR litigation, it is clear there was no reasonably equivalent value, so the case comes down to whether the transaction resulted in insolvency, unreasonably small capital or an inability to pay maturing debts. But, "solvency" is often hard to establish because it is measured as of the time of the transaction and is determined on a going concern basis. "Inability to pay" maturing debts can be even more problematic (although few cases find an inability to pay maturing debt without also finding unreasonably small capital) because those structuring the transaction can significantly increase the time before there is an "inability to pay" by permitting payment-in-kind or PIK interest (which, while limiting cash outflows, increases the debt) and/or by deferring principal payments on LBO and LR debt for two, or even four, years. So, the cases frequently turn to the "unreasonably small capital" test because it does seem to focus on the future and the likelihood of future financial problems.

On that issue, defendants received a strong dose of protection in *Moody v. Security Pacific Business Credit, Inc.*, 971 F.2d 1056 (3d Cir. 1992). *Moody* involved a leveraged buyout of Jeannette Corporation on July 31, 1981, for a sale price of $12.1 million, financed by a revolving line of credit of $11.7 million. After the buyout, Jeannette initially tracked expectations, but things soon went downhill; and, on October 4, 1982, an involuntary petition was filed, with the trustee later bringing a fraudulent conveyance lawsuit. The lower courts ruled for the defendants, and the Court of Appeals affirmed. Most significantly, the court suggested that an unreasonably small capital determination required that it be "reasonably foreseeable that the acquisition would fail" based on "reasonable" projections (giving effect to any existing line of credit). Moreover, although the court recognized that "projections tend to be optimistic" and that these were not "entirely on the mark," they were not unreasonable; the demise resulted from intense competition, a continued recession and mismanagement.

Although the *Moody* holding was somewhat dissipated over time, it was reinforced in early 2016 by two court of appeals decisions (although both were summary orders, with no precedential value). In the first, *In re Adelphia Communications Corp.*, 653 Fed. Appx. 19 (2d Cir. 2016), the debtor purchased its own stock and the trustee sought recovery from the sellers of the repurchased stock. The trustee cited evidence of financial issues, negative cash flow, ongoing fraud within the company,

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and default on existing bonds, but the court held the debtor could have sold assets or obtained sufficient credit for the foreseeable future, and cited expert testimony that similarly situated companies in the cable industry had been able to access the capital markets after disclosing a fraud.

In the second, *In re Semcrude L.P.*, 648 Fed. Appx. 205 (3d Cir. 2016), the trustee sought to recover two equity distributions in the bankruptcy that followed the first distribution by less than a year and the second by only five months. But, despite *Semcrude's* having violated the terms of its credit agreement and the banks having ultimately declared a default, the court of appeals concluded that *Semcrude* would have been adequately capitalized if it could have drawn on its credit facilities, and that the trustee's argument that it was reasonably foreseeable that *Semcrude* would not have had access to the line of credit because of improper trading activities rested on conjecture (citing a case for the proposition that "unreasonably small" is "fuzzy, and in danger of being interpreted under the influence of hindsight bias"). Ultimately, it "came down to a battle of experts"; and, obviously, defendants had the advantage of having prepared their story at the time the transactions took place.

There are significant themes in these opinions, but all are doubtful in the real world. First, the existence of a line of credit does not assure the availability of funds. Lenders have significant power to declare defaults, refuse advances, insist on loan modifications, or take other steps that negatively affect the business. Second, the denigration of "hindsight bias" seems an attempt to overcome the common sense view that, if bankruptcy follows shortly after the leveraged transaction (or reflects a consistent decline), capital probably was inadequate. Third, supposed "uncertainty" over "unreasonably small capital" simply avoids analysis. And, finally, insisting on "reasonable foreseeability" and the near certainty of bankruptcy—while ignoring financial devices (such as, PIK interest, long maturities, and principal deferrals) that postpone the inevitable—approaches a requirement that the debtor be clairvoyant.

It is striking that the cases above did not discuss the impact of the much higher level of credit risk on the business, and the changes in operations that were required to deal with the increased debt (especially true in *Moody*) and new management. They also ignored the fact that, in many questionable transactions, the dealmakers began to frame the issues, employ experts (who often act more like transactional advocates than dispassionate observers), and prepare their best case, at the time of the transaction. The key fact of leveraged transactions (as recently illustrated in cases following leveraged transactions in the oil and gas and retail industries) is not that they *will* lead to bankruptcy, but that the margin for error (and the ability to deal with almost any unanticipated circumstance or new situation) is significantly reduced, without any benefit to creditors or the business.

The Section 546(e) and Other Defenses

Section 546(e) provides a safe harbor for margin or settlement payments made by or to (or for the benefit of) a financial institution or certain other named parties, or a transfer by or to (or for the benefit of) a financial institution in connection with a securities contract. Its predecessor was first enacted in 1978 and amended several times; and the legislative history indicates that Congress was especially concerned with the possibility of a broad market meltdown and the cascading effect on market participants. There is no indication that Congress intended section 546(e) to have a broad effect on bankruptcy avoiding powers or to provide a vehicle for parties to "structure" their way out of liability under avoiding power statutes.

But gradually, bankruptcy lawyers began to realize section 546(e)'s potential as a defense to avoiding powers; and they have used it increasingly. Five courts of appeals decisions have held that section 546(e) applies to a transfer that involves a financial institution or one of the other financial parties mentioned in the statute, even though such party had not received or been the beneficiary of the transfer subject to avoidance; in other words, it applies to any transfer involving financial intermediaries (even if they had no beneficial interest in the transaction), thereby protecting the party actually receiving the transfer (even though that party was not named as a protected party in section 546(e)). In the real world, since the typical LBO or LR almost always involves wire transfers, this interpretation protected virtually all recipients of funds in LBO or LR transactions.

To be sure, there were some ways out. Section 546(e) was not applicable to transfers with the actual intent to defraud, but this standard was difficult to meet in a commercial transaction. Another possibility was to rely on state law avoidance powers to bypass the section 546(e) issue by having creditors transfer their avoidance claims to a litigation trustee for prosecution, and having the trustee argue that section 546(e) was not applicable because the trustee was proceeding under state law, and not under section 544(b) (which would trigger 546(e)). The initial cases were split, but in *In re Tribune Company Fraudulent Conveyance Litigation*, 818 F.3d 98 (2d Cir. 2016), the Second Circuit held that the failure to apply section 546(e) to the trustee's action would undermine the statute.

But, there were other defenses as well: Section 548's two year statute of limitations; and, if the debtor were a limited partnership or LLC, state LP or LLC laws with provisions that limit the ability to avoid distributions to equity holders to three years (arguably, preempting the longer state statutes of limitations that a trustee could invoke under section 544(b)—which were usually four, and sometimes six or more, years). See *In re Century City Doctors Hospital, LLC*, 466 B.R. 1 (Bk. C.D. Cal. 2012) (applying section 17-607(a) of the Delaware URULPA); Del. LLC Act § 18-607(c); NY LLC Law § 508(c). And, if the trustee were asserting a state law fraudulent conveyance under section 544(b), the defense of ratification (or similar doctrines) to preclude recoveries by debtholders who participated in the offending transactions and their assigns. See *In re Lyondell Chemical Co.*, 503 B.R. 348, 383-85 & nn. 174-76 (Bk. S.D.N.Y. 2014) (citing authorities).

The result of these statutes and decisions was that LBO and LR transactions were

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largely free from the threat of avoidance as fraudulent transfers under both section 548 and state law.

The Wheel Turns

Beginning in June of 2016, something changed: three decisions seemed to resuscitate the possible application of fraudulent transfer law to LBO transactions.

The first, and probably most significant, is *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016), involving the section 546(e) defense discussed earlier. Here, the Court acknowledged that section 546(e)'s language was ambiguous, and held that the defense can only be used by a protected party named in the statute that received or was the beneficiary of the subject transfer, and not simply because a financial institution or other protected party was an intermediary or conduit. Looking broadly at the relevant statutes, including the protections that Congress expressly provided to transferees (such as, the limited protections of section 548(d)(2) and the limited protection for recipients of charitable contributions) and the legislative history, the Court reasoned that section 546(e) was intended to protect only parties named in the statute who were actual recipients or beneficiaries of the transfer (thereby preventing a large bankruptcy from causing systemic risk to financial markets), not to extend its protection to non-named recipients or beneficiaries of the transfer merely because of the involvement of a named financial party as an intermediary or conduit bearing no risk from the transfer's avoidance. The court recognized that five circuits were *contra*, but noted that the Eleventh Circuit had earlier agreed with its conclusion. Given this circuit split, a Supreme Court review is a real possibility.

The second is the decision by the bankruptcy court in Delaware in *In re Physiotherapy Holdings, Inc.*, 2016 WL 3611831 (Bk. D. Del. 2016). The *Physiotherapy* court disagreed with the *Tribune* decision on the preemption of state fraudulent conveyance law in a case brought by a trustee asserting the assigned rights of creditors and dealing with accounting fraud discovered by the new owner's accountants four years after the transaction in question. The court suggested that, at least where there was no threat of a ripple or destabilizing effect on the relevant securities or financial markets and the transferees received payment for nonpublic securities, section 546(e) simply limited the trustee's ability to bring a fraudulent conveyance action, not a creditor's. The *Physiotherapy* court also held that the defense of ratification (discussed earlier) was not applicable to noteholders who purchased in reliance on the fraudulent financial statements.

In the third, *In re Lyondell Chemical Co.*, 554 B.R. 635 (S.D.N.Y. 2016), Judge Cote reversed a bankruptcy court's decision granting a motion to dismiss a complaint asserting an "actual intent" fraudulent conveyance in an LBO case. There, it was alleged that the CEO intentionally misstated projections and that the Board went along. The Court held that the knowledge of fraudulent projections could be imputed to the debtor pursuant to Delaware law and ordinary agency principles, since they were made within the scope of authority and duties of the CEO; and that plaintiff could plead either actual intent or a belief that harm was substantially certain to occur. Here, plaintiff adequately pled that the CEO and the management team had a motive to commit fraud to secure benefits, and three badges of fraud—a transfer of substantially all assets, transfers to insiders in the form of payments, and the debtor's having become insolvent soon after the transactions. To be sure, Judge Cote's decision was helped by the fact that the CEO had predicted bankruptcy in the event of an LBO. It has generally been considered difficult to successfully assert an actual intent fraudulent conveyance; and, while *Lyondell* certainly requires some fraud or dishonesty in the course of the transaction, there may be many situations where this is not difficult to find. The *Physiotherapy* case, discussed above, is to the same effect. See also *In re Sentinel Management Group, Inc.*, 728 F.3d 660 (7th Cir. 2013) (sustaining factual findings of an actual intent fraudulent transfer when the debtor transferred customer assets out of segregated accounts, and "knowingly exposed its FCM claimants to a substantial risk of loss of which they were unaware").

Important postscripts to these cases come in two areas involving, not constructive fraudulent transfers, but fraudulent transfers made with "actual intent to hinder, delay or defraud." First, from the Supreme Court's recent decision in *Husky Int'l. Elecs., Inc. v. Ritz*, 136 Sup. Ct. 1581 (2016), holding that claims arising out of "actual intent" fraudulent transfers constitute "actual fraud" and are not dischargeable in a personal bankruptcy; and, second, in the area of discovery, where the Supreme Court's definition of "actual fraud" in *Husky* can be used to bolster the argument that the crime-fraud exception to the attorney-client privilege applies in cases involving actual intent fraudulent transfers.

In *Husky*, an unpaid creditor asserted that its obligor had carried out numerous fraudulent transfers to strip itself of assets, and that Ritz (the controlling stockholder) was personally liable pursuant to a Texas statute permitting veil piercing in cases of "actual fraud" for the "direct personal benefit of the beneficial owner." The Supreme Court, relying heavily on historical precedent going back to the Statute of 13 Elizabeth in 1571, held that "the common-law term 'actual fraud' is broad enough to incorporate a fraudulent conveyance" and "anything that counts as 'fraud' and is done with actual intent is 'actual fraud.'" Consequently, section 523(a)(2)(A)'s exception to discharge for debts obtained by "actual fraud" could be applied to a shareholder's liability under state law for "concealment and hindrance" giving rise to a "fraudulent conveyance of property made to evade payment to creditors." A strong argument can be made that *Husky* and the "badges of fraud" concept should now be read into "actual intent" under section 548(a)(1)(A).

The discovery issue is dealt with in *Fragin v. First Funds Holdings LLC, et al.*, Index No. 652673/2014 (Sup. Ct. NY Co. 8/11/16), 2016 NY Slip Op 31537(U), a case also involving an actual intent fraudulent transfer. The plaintiff in *Fragin* alleged that defendants had transferred assets to a related entity to strip one of the defendants of assets, and brought the lawsuit against the

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transferees as well as their investment advisor and legal counsel (claiming that they had aided the transfers). Plaintiff sought discovery against legal counsel and, in response to counsel's claim of privilege, asserted the crime-fraud exception. The court held that the crime-fraud exception encompassed a fraudulent scheme or other wrongful conduct, and that there was probable cause to believe the defendants had committed an actual intent fraudulent conveyance based on the presence of various badges of fraud (including, the transfers having been made in the midst of litigation alleging significant debt owed by the transferor to its creditors; the close relationship of the transferor and the transferee, with insiders being left in control; and the transferor's having receiving no cash for the transfer of substantially all of its assets). The court, therefore, held that the communications with legal counsel sought in discovery were in furtherance of the alleged fraud and the crime-fraud exception applied. It is likely that the *Lyondell* plaintiffs will seek similar discovery. The second priority note holders in *Caesars* have already done so (See *Caesars,* Docket No. 4803).

Conclusion

Recent decisions suggest that the pendulum may be swinging toward a greater acceptance of the role that fraudulent transfer litigation can play after an LBO or LR fails; which may also provide clearer ground rules for structuring transactions in the future. The previously prevailing state of affairs may have been good for those who structured the LBOs and LRs, with the risk being borne by others; but it had little redeeming social value.

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BUSINESS LAW TODAY

Sustainability Meets Integrity

By John H. Stout

"Business sustainability" has become an important addition to board/management discussions in recent years. While the term "sustainability" has long had environmental implications, sustainability has become an umbrella for many topics, including agriculture, food, deforestation, energy resources, various human rights issues, carbon and other emissions comprising a global concern for meeting society's current interests and needs in a manner which does not compromise the interests and needs of future generations and is protective of the planet. "Business sustainability" focuses on a company's ability to conduct its activities and build shareholder value over the long term, balancing the need for short-term results while adapting business strategies and operations to assure long-term value creation consistent with sustainable business practices. Inherent in meeting these challenges, companies are required by law to maintain a culture that embraces ethical values and legal compliance.

Issues with corporate conduct have been with us since corporations became a recognized means of amassing capital for a business activities while at the same time limiting the risk of those who provided the capital and conducted the business activities. However, in the late 1900s and early 2000s, from Enron to the present day, the challenges of business misconduct, and failures of business integrity, have attracted the media, the courts, regulators, and lawmakers. *Sarbanes Oxley* was passed in the wake of Enron and the many corporate failures occurring at that time. *Dodd Frank* was passed following the financial crisis precipitated by widespread misconduct in the financial services industry. Currently, as we experience the misconduct of Volkswagen and Wells Fargo, it is clear that the promotion of corporate integrity defies legislative and regulatory solutions. What's needed is a redoubling of board and management initiatives to focus on achieving a high standard of corporate integrity on which a company's shareholders and many other stakeholders can safely rely.

Integrity is the foundation on which sustainable businesses must be built. Without integrity as the fundamental principle, there can be no sustainable business, there will be no culture of ethics and legal compliance. What shareholders and other stakeholders most need from boards of directors, as the governing bodies of the companies serve, is the assurance of their companies' integrity. Specifically:

- That the company has a clear business mission and values formed on balancing short-term performance with long-term enterprise sustainability, adaptability, viability, and performance.
- That the company's business model is sustainable and that the long- and short-term risks and opportunities which accompany that model have been carefully vetted by the board, and that its strategic plans, operating plans, and business conduct embrace the governance, ethics, environmental, energy, and social practices essential to long- and short-term value creation and performance.
- That the company's financial and nonfinancial reporting has integrity, and can be clearly understood and relied on by those responsible for assessing, financing, working for, and doing business with the company.
- That the company's public disclosures and the comments of senior management and the board have integrity and are reflective of the true state of the company's values, business activities, and financial and nonfinancial results.
- That the company's CEO , selected, compensated, and regularly evaluated by the board, and the senior management team

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engaged by that CEO, would above all of their responsibilities, see that the company's affairs are conducted in a manner which serves rather than detracts from, the company's integrity and reputation.

- That the compensation and perks awarded to board members and senior management, which directors alone approve, will not in actuality or perception, corrupt their judgment, compromise their independence, corrupt the company's culture, or otherwise detract from the company's integrity and reputation.
- That the company's compensation and incentive plans for nonmanagement employees and those doing business with the company will promote rather than corrupt ethical conduct on the part of all employees, suppliers, and customers.
- That directors and management will avoid actual or perceived conflicts of interest which would detract from the integrity of the company and its governance.
- That management has in place compliance systems and procedures that will provide warnings of activities that would threaten the integrity and sustainability of the company, proactively overseen by the board, and when warnings come that management and the board will investigate the issues fully, independently, and without compromising restrictions, use the results to transparently address issues and needed corrections.

The bottom line of a sustainable governance system and sustainable business conduct, is that the company's ultimate authority, i.e. its board of directors, is proactive and vigorous in taking responsibility for the company's integrity. From Enron to Volkswagen and now Wells Fargo, many of the corporate scandals occurred because boards failed to take responsibility for the company's integrity, long-term value creation, and ultimate sustainability. The directors apparently did not see the company's integrity as an extension of their own, and ultimately this is a critical point.

Given that boards are responsible for overseeing and assuring the development and maintenance of a culture of integrity, ethics, and legal compliance they must be proactive in the use of the tools at their disposal for this challenging task. Key among these tools are:

- Recommending the election of capable directors, persons known for their integrity, ethics, commitment to legal compliance, and understand that these are critical elements of a sustainable company; persons who understand what it means to be a fiduciary and their fiduciary duties; persons who are knowledgeable about governance and oversight and possess the skills, time, energy, judgment, leadership, and courage to effectively discharge their responsibilities. Everything starts with board composition.
- Periodically refreshing the board with directors having a variety of skillsets, including an awareness of contemporary subjects applicable to the company, its shareholders and other stakeholders such as cyber risk, social media usage, and business sustainability and social responsibility.
- Selection of independent board leadership with the knowledge and skills to assist the board in meeting its responsibilities.
- Selection, compensation, and evaluation of a CEO known to be ethical, and screened for past integrity, legal and ethical issues, who is experienced and committed to building and maintaining a corporate culture of integrity, ethics, and legal compliance, and has demonstrated an ability to balance short- and long-term value creation and performance.
- Periodic independent assessment of the company's culture, ethics, values, compliance with laws and regulations, and effectiveness of training programs designed to instill appropriate corporate values, familiarize employees with the company's expectations as to ethics, compliance, and integrity, as well as systems designed to test the effectiveness of those training programs.
- Recognizing that in every company there is an enterprise-wide culture and many subcultures, including the boardroom culture, the board/management culture, and cultures within subsidiaries, divisions, and workgroups. It is important to harmonize these cultures with the overall enterprise culture and values and to assess the degree to which that has occurred.
- Periodic one-on-one interaction with key senior executives and mid-level managers, internal and external auditors, compliance personnel (particularly those responsible for company hotlines and complaint gathering systems), key group and division leaders, internal and external legal counsel, and the executive in charge of human resources, to gain insight into the company's culture, and the elements of integrity, ethics, and legal compliance.
- Assurance that management has in place processes and procedures for preventing and detecting integrity lapses, ethical issues, and violations of laws, regulations, company governing documents, including codes of conduct and other company policies, and for assessing risk and risk mitigation followed up with oversight over, and periodic assessment of, the efficacy of those processes and procedures.
- Oversight over the evaluation, hiring, firing, and compensation of employees who are key to assessing, shaping, and managing the corporation's financial reporting, legal resources, human resources, risk assessment, ethical and legal compliance environment (e.g., the CFO, controller, internal auditor, risk manager, investment relations officer, internal counsel, heads of human resources and information technology/security, and person in charge of sustainability matters). Periodic one-on-one interviews with these individuals are an essential board/committee assessment and oversight tool.
- Engagement by the board of independent auditors and compensation consultants, as well as oversight over management's engagement of outside legal counsel and other key advisors to assure that the loyalty of these advisors is to the company, the board and not primarily to the personnel of the company who engaged them, and confirming that they recognize their responsibilities to the board and its committees and their roles in enhancing the effectiveness of the board and its committees.

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- Periodic engagement of independent third parties to advise the board and its committees on matters with respect to which the board requires a "second opinion" or advice from a source which is not regularly engaged to serve the company under management's direction.
- Use of tools such as business intelligence and balanced score carding to assist with monitoring the company's operations.
- Use of corporate and outside investigatory and research resources to scan the backgrounds of key people and companies which the company is engaging directly or as outside vendors.
- Engagement with management in vigorous, candid dialogue regarding strategy, opportunities, operations, sustainability issues and risks, and rewards associated with the same, and seeking dialogue with various management personnel regarding concerns about corporate direction.
- Constantly seeking to understand risks, paying attention to warnings, and confronting problems promptly and forthrightly. Policies and procedures for assessing and monitoring risks are essential and directors must assure that they are in place and functioning well. Warnings need to be heeded and promptly investigated. Investigation means a thorough effort to obtain all relevant information using independent resources where necessary to assure objectivity. History, including Volkswagen and Wells Fargo, provides ample lessons of the disastrous consequences of cover-ups and understanding financial and nonfinancial impact once a problem is discovered.
- Monitoring the company's public disclosures and management comments for integrity and reputational impact, as well as credible third party commentary regarding the company, its goods and services, the performance of and conduct of its key people, and its reputation for business conduct and integrity.
- That the public disclosures by the company, and comments of senior management and the board regarding material company affairs have integrity.

Key to markets for talent, goods and services, investment, financings, corporate transactions, and ultimately the sustainability and long-term value creation of companies, is the integrity of the company, the goods and services it produces, and the information it provides, and the people it employs. Serious lapses in corporate integrity have resulted in substantial, sometimes tragic, financial and nonfinancial consequences for employees, vendors, customers, financing parties, shareholders, and other stakeholders. Boards must redouble their efforts to assure the integrity of the companies they govern. Ultimately, the sustainability of our free enterprise system depends on it.

John H. Stout is the Immediate Past Chair of the Business Law Section's Corporate Governance Committee. He currently serves as Vice Chair of the Section's Corporate Social Responsibility Committee and is a member of the Section's Governing Council. Stout is an Officer and Shareholder of the Midwest regional firm of Fredrikson & Byron where he Co-Chairs the Corporate Governance Group with Elizabeth Dunshee, and Chairs the Business Sustainability and Social Responsibility Group. Stout is an Adjunct Professor at the University of St. Thomas Law School, teaching Corporate Governance, and periodically serves as an expert witness on governance matters.

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BUSINESS LAW TODAY

Buying Assets in Bankruptcy: Has the Second Circuit Taken the Wind Out of Sales Free and Clear?

By Jeanne P. Darcey

Introduction

A bankruptcy filing often signals a stark reality for a faltering business: profits fell woefully short of projections, once-hopeful business strategies failed, and a complete shut down potentially is imminent. However, a chapter 11 proceeding can also lead to opportunity: a business may seek to rid itself of unneeded business lines or assets—or sell itself entirely—to bring in cash for its creditors, or on the buy-side, a purchaser may seek to make a lucrative and perhaps pennies-on-the-dollar acquisition without assuming the liabilities of the seller. A key aspect of any bankruptcy sale transaction is the ability for the purchaser to acquire a business, or specific assets, "free and clear" of the problems (and liabilities) of the debtor-seller. The boundaries of free and clear have been fluid and expansive; however, the Second Circuit's recent decision in *Celestine Elliott, et al. v. General Motors LLC (In re Motors Liquidation Co.),* 829 F.3d 135 (2d Cir. 2016), establishes that the protections afforded by a free-and-clear sale order certainly are not limitless.

Statutory Framework

Section 363 of the Bankruptcy Code

The Bankruptcy Code provides a debtor with several avenues for disposing unneeded or burdensome assets, the cornerstone of which is section 363. This section permits a debtor to sell its assets outside of the ordinary course of business free and clear of all liens, claims, encumbrances, or other interests of other parties, so long as certain conditions set forth in section 363(f) are satisfied. Bankruptcy practitioners tout the use of section 363 and generally agree that an acquisition through a bankruptcy sale can provide a purchaser with the "cleanest" title possible. Why so good? A bankruptcy sale will allow a purchaser to buy assets (or an entire business for that matter) and leave any and all liens, claims, encumbrances, and other liabilities to be resolved as part of the bankruptcy case.

Through the use of section 363, a debtor may file a sale motion at any time and establish sale procedures intended to maximize value for the estate. In addition, local bankruptcy rules generally will require that other interested parties be given the opportunity to make a counteroffer, in which case the process will include some type of open or sealed-bid auction to determine the highest and best offer for the assets. Further, the bankruptcy court often will sanction bid protections in the form of overbid and incremental bidding levels, as well as reimbursement for expenses payable to the initial "stalking-horse" bidder if it is not ultimately the successful buyer at the auction.

Plan Sales

The principal goal of any chapter 11 case is to confirm a plan of reorganization that provides acceptable recoveries to creditors. Section 1129(a) sets forth specifically enumerated requirements that must be satisfied for plan confirmation to occur, including that the plan be accepted by each "impaired" class of creditors. Acceptance is articulated in section 1126(c), which provides that a class of claims has accepted a plan if at least two-thirds in dollar amount and more than a majority in number of claims in such class have voted in favor of the plan.

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Although labeled the "reorganization" chapter of the Bankruptcy Code, and traditionally used by businesses to restructure their burdensome debt loads and emerge as financially stronger going-concern businesses, a plan may seek to implement a sale of all or any part of the property of the debtor to in order to provide recovery to creditors. Unlike a section 363 sale that can be accomplished by motion, a plan sale necessarily implicates the panoply of plan confirmation requirements. There must be an adequate disclosure statement approved by the court to accompany the plan, voting by creditors, and a confirmation hearing held that requires the debtor to satisfy each of the 16 requirements set forth in section 1129. Consequently, a sale through the mechanism of a plan may be a lengthier process than under section 363.

Section 363 Sale vs. Plan Sale

Once a decision is made that a sale should occur, the parties must determine whether it is appropriate to proceed through a sale under section 363 or by way of a plan. Traditionally, section 363 is used for sales of specific assets that can be sold in order to bring cash into the estate without affecting the balance of the restructured business operations. A sale of all or substantially all of a debtor's assets, however, historically occurs under a plan of reorganization. Why the difference? A sale under section 363 makes sense if it can occur fairly early on so that potentially idle assets can be sold and provide the debtor with much-needed cash. In addition, because those assets do not affect the entirety of the business, the sale of those assets (and the proceeds received upon their sale) will not be the key determinant of distributions to creditors under a yet-to-be approved plan of reorganization.

On the other hand, a sale of an entire business presumably will gut the estate of all operations and provide the only cash (or cash equivalents) that will be derived in the proceeding. The sole issue remaining after such a sale will be how to divide the proceeds among creditors. For all practical purposes, then, the sale of all or substantially all of the assets constitutes the plan because there is nothing more to do as part of the reorganization process. Therefore, such sales historically have occurred as part of the plan process, providing creditors with the full procedural safeguards attendant to plan confirmation: adequate disclosure of the sale, the classification of creditor claims and the manner in which the sale proceeds will be distributed among those classes, and, ultimately, the necessity of obtaining acceptance of the plan by creditor vote.

Over recent decades, however, the use of the section 363 sale process for entire businesses has gained favor and been approved by the courts so long as adequate notice and opportunity to be heard has been given to parties in interest, and a sound business justification for the sale has been demonstrated. In fact, the rise in use of section 363 sales garnered attention from a leading commission studying necessary reforms to chapter 11. In its December 8, 2014 *Report of the ABI Commission to Study the Reform of Chapter 11* (the Report), the American Bankruptcy Institute Commission (the Commission) recommends the inclusion of a new subsection to section 363 specifically addressing the sale of substantially all of a debtor's assets. Interestingly, the Commission recommends that a sale of substantially all of a debtor's assets should not occur within the first 60 days of a case, absent clear and convincing evidence of extraordinary circumstances (such as a showing that there is a high likelihood that the value of the assets will decrease significantly during the 60-day period). In addition, the motion to sell must satisfy certain conditions customary within the plan process, including sufficient notice to creditors and proof, by a preponderance of the evidence, that the proposed sale is in the best interest of the estate and satisfies the plan requirements set out in sections 1129(a)(1)–(4) and (a)(9)(A).

So . . . Just How Free and Clear Is "Free and Clear"?

Free and Clear of Claims

The banner phrase for a bankruptcy sale, whether approved by motion under section 363 or through the plan confirmation process, is that the sale is free and clear of all liens, claims, encumbrances, and other interests in the property of the estate. Most of the cases have revolved around known liens, claims, and encumbrances, and the jurisprudence appears quite clear: the sale can be affected free and clear, with any such liens, claims, and encumbrances attaching to the proceeds of sale, in their respective orders of priority, provided that all holders of such liens, claims, and encumbrances were given proper notice of the sale and an opportunity to object. No need for much discussion on that topic, but should *unknown* claims also be defeated by a purchaser holding a free-and-clear sale order?

At the forefront of the discussion on the enforceability of free and clear sale orders is the *GM* case. On June 1, 2009, General Motors Corporation (Old GM) filed a petition under chapter 11 in the United States Bankruptcy Court for the Southern District of New York. On the first day of its case, Old GM also filed a motion, pursuant to section 363, to sell to General Motors LLC (New GM) a substantial portion of its business free and clear of all liens, claims, encumbrances, and other interests, other than expressly defined "assumed liabilities." New GM had agreed, for example, to assume liabilities for post-sale accidents involving both Old GM and New GM vehicles and liabilities under the express warranty on the sale of any Old GM or New GM vehicle. After much negotiation with various states' attorneys general, New GM also agreed to assume liabilities under "lemon laws" for both Old GM and New GM vehicles.

Included as part of the draft proposed sale order was a finding that Old GM may "sell the Purchased Assets free and clear of all liens, claims, encumbrances, and other interests, *including rights or claims based on any successor or transferee liability*. Second, the Proposed Sale Order would enjoin all persons (including litigation claimants) holding liens, claims, encumbrances, and other interests, including rights or claims based on any successor or transferee liability, from asserting them against New GM or the Purchased Assets."

The bankruptcy court required extensive notice of the sale and proposed order. It re-

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quired *actual* notice to all parties who were known to have asserted any lien, claim, encumbrance, or interest in assets being purchased and notice by publication of the sale to all 70 million owners of Old GM automobiles.

Fast-forward to 2014 when New GM announces for the first time serious defects in ignition switches (the Ignition Switch Defect) installed in as many as 27 million of the 70 million Old GM automobiles, going back to the 2005 model year. Bankruptcy Judge Gerber recited in his decision in the case that "at least 24 business and in-house legal personnel at Old GM were aware of the problem. As of June 2009, when entry of the Sale Order was sought, Old GM had enough knowledge of the Ignition Switch Defect to be required, under the National Traffic and Motor Vehicle Safety Act (the Safety Act), to send out mailed recall notices to owners of affected Old GM vehicles. And Old GM knew to whom it had to mail the recall notices, and had addresses for them."

Old GM failed to give *any* actual notice, however. Not only did Old GM fail to provide owners of the defective automobiles with actual notice of the proposed sale, but Old GM also had failed to provide them with a recall notice, *at any time*. Consequently, even if the owners of the defective automobile had learned about the sale through publication, they would have had no idea if they had a claim that could be affected by a sale because they had never received a recall notice!

Once New GM issued a recall of the affected vehicles in 2014 (through which New GM agreed to replace the Ignition Switch Defect at its expense), class actions were commenced almost immediately by four different groups who were not given actual notice of the bankruptcy sale: (1) preclosing accident claims; (2) economic loss claims arising from the Ignition Switch Defect of other defects; (3) independent claims arising from New GM's conduct; and (4) used car purchasers' claims. Bankruptcy Judge Gerber had to determine if the free-and-clear sale order could survive and be enforceable against those plaintiffs who had not received actual notice of the sale. He found that virtually all of the arguments of the class-action plaintiffs were raised at the sale hearing by other parties through able counsel and were properly addressed by the court. Thus, Judge Gerber concluded that a lack of due process could be overcome by "proxy" if a party cannot demonstrate that it would have made different arguments than those parties with notice who had objected to the free-and-clear provision.

The Second Circuit Appeal

On appeal, the Second Circuit confirmed the use of section 363 for preplan sales of all or substantially all assets and articulated that a bankruptcy court may approve a sale under section 363 free and clear of successor liability claims. Section 363 continues to be a valuable tool for failing businesses. The court clearly articulated that, to protect a purchaser from a seller's liability, the "claim must arise from (1) a right to payment (2) that arose before the filing of the petition or resulted from pre-petition conduct fairly giving rise to the claim. Further, there must be some contact or relationship between the debtor and the claimant such that the claimant is identifiable."

Applying this standard, the Second Circuit determined that not all of the claims at issue were covered by the sale order. As to independent claims, such claims were based on New GM's conduct and therefore did not have the requisite contact with the debtor; for used-car claimants, those parties purchased Old GM cars after the closing without knowledge of the defect and therefore had no relationship with Old GM prior to its bankruptcy filing. Therefore, the sale order could not insulate New GM from liability for these sets of claims because there was never an existing relationship between the claimant and Old GM.

The Second Circuit found that the other two groups—the preclosing accident and economic loss claimants—fell within the bounds of the articulated test and within the purview of the sale order. On appeal, those claimants argued that, even if the sale order applied to them, enforcing it to preclude their claims would violate due process. The Second Circuit agreed.

First, the Second Circuit agreed with the bankruptcy court that notice by publication to these claimants was not enough. Old GM knew or reasonably should have known that a defect existed, and also knew the identity of the affected parties; however, that is where the Second Circuit's agreement with the bankruptcy court ended.

Importantly, Bankruptcy Judge Gerber determined that the sale order could survive so long as such claimants were not prejudiced by the lack of due process. Further, Judge Gerber concluded that he would have entered the sale order even if the claimants had filed their objections because they raised no unique objections from parties who had been notified of the sale and who had had their day in court. In addition, the failure to approve the sale was untenable to Judge Gerber. The Second Circuit disagreed. In fact, the circuit court determined that it did not even have to decide if prejudice was a necessary element of a due process claim because it found that the claimants had demonstrated prejudice. Had notice been given, the claimants could have been at the negotiating table, and, similar to the states attorneys general in the case of state "lemon laws," they could have negotiated an outcome to have their claims assumed by New GM. Without that opportunity, these claimants were prejudiced. Moreover, the Second Circuit was not convinced that Armageddon would result if the sale were not approved; instead, the court believed that other alternatives might have been available if the sale order was not so hastily approved. Finally, there appears to be a clear distaste for a result that would bar these claimants from recovery. A sale to New GM (made up of Old GM's business and personnel) should not insulate New GM from known, contingent claimants as a result of the failure to provide notice. Unless the U.S. Supreme Court determines to weigh in on successor liability, New GM must cover the claims of all of such parties. The upshot for any purchaser out of bankruptcy: ensure that the debtor provides widespread, actual notice.

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Free and Clear of Interests

A separate line of cases has involved challenges to free-and-clear sale orders by asserting that the rights ("claims") asserted against the successor/purchaser do not constitute "interests" for purposes of section 363 and therefore survive the sale. Section 363(f) provides that a debtor "may sell property under subsection (b) or (c) of this section free and clear of *any interest* of an entity other than the estate . . . ." (emphasis supplied). Although the Bankruptcy Code does not define "interest" for purposes of section 363, those challenging free-and-clear sale orders assert that the term must be interpreted narrowly to mean only in rem interests, such as liens and security interests, that attach to property. Such an interpretation is bolstered by the words of the statute itself: "free and clear of *any interest in such property*." Thus, the types of interests impacted by a sale free and clear are in rem interests that have attached to the property.

The Sixth Circuit agreed with such an approach in *Michigan Emp't Sec. Comm'n v. Wolverine Radio Co.* (*In re Wolverine Radio Co.*), 930 F.2d 1132 (6th Cir. 1991), and held that the debtor's unemployment contribution rating was not an *interest* within the meaning of section 363. *Wolverine* involved the free-and-clear sale of all of the business of Wolverine Radio Company (Wolverine). The Michigan Employment Security Commission (MESC) had filed a claim against Wolverine for unpaid taxes, interest, and penalties in the amount of $7,606.91 and presumably had been notified of the plan and sale. Initially, MESC informed the buyer that it would impose an unemployment tax rate of 2.7 percent based on the buyer's status as a new employer. Later that year, however, MESC altered its position, determined the buyer to be a successor of Wolverine, and demanded a contribution rate of 10 percent based on Wolverine's poor experience rating prior to the chapter 11 petition. MESC used Wolverine's prior 60-month payroll and benefits charges to assess a contribution rate of 10 percent.

MESC argued that the debtor's experience rating did not constitute an interest for purposes of section 363, and the court agreed. "Similarly, while 11 U.S.C. Sec. § 363(f) provides that property may be sold 'free and clear of any interest in such property,' we do not perceive the experience history of Wolverine as an 'interest' that attaches to property ownership so as to cloud its title. . . ." Because the debtor's experience rating was held not to be an *interest* for purposes of section 363, the Sixth Circuit affirmed the imposition of the higher rating on the successor corporation despite the free-and-clear sale language set forth in the plan. In dicta, the court stated that, even if a contribution rate constituted an interest for purposes of section 363, the conditions set forth in subsection (f) could never be satisfied to permit a sale free and clear.

The growing trend, however, is to interpret the term "any interest" much more broadly. See, e.g., *Indiana State Police Pension Tr. v. Chrysler LLC (In re Chrysler LLC),* 576 F.3d 108 (2d Cir. 2009) (personal injury claims related to pre-sale automobile accidents were interests for purposes of section 363); *In re Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003) (the term interest is sufficiently broad to include the debtor's possessory rights as lessee); *In re Trans World Airlines, Inc.*, 322 F.3d 283 (3d Cir. 2003) (rights to travel vouchers given to flight attendants in settlement of employment discrimination claims were interests for purposes of section 363); *United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co*. (*In re Leckie Smokeless Coal Co*.), 99 F.3d 573 (4th Cir. 1996) (debtor's obligation to fund retirement plan was interest for purposes of statute); *In re General Motors Corp*., 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (following *Chrysler*).

These cases suggest that the term "interest" should be defined broadly to include all types of obligations that may flow from the ownership of property. See *Trans World Airlines, Inc.*, 322 F.3d at 289. Following this trend is a recent 2013 case from the Bankruptcy Appellate Panel for the First Circuit. In *Massachusetts Dep't of Unemployment Assistance v. OPK Biotech, LLC* (*In re PBBPC, Inc., f/k/a Biopure Corp.*), BAP No. MB 12-042 (B.A.P. 1st Cir. Jan. 17, 2013), the panel, applying a broad interpretation to the term "interests," precluded imposition of a debtor's unemployment rating on a section 363 purchaser.

Although the facts in *PBBPC* are eerily similar to *Wolverine,* the panel reached a directly contrary conclusion. After a sale under section 363, the Massachusetts Department of Unemployment Assistance (DUA) notified the purchaser that it would be liable as a "successor employer" to the debtor, with a contribution rate of 12.27 percent rather than the rate of 2.89 percent imposed upon new employers. Among other arguments, the DUA stated that the contribution rate was not an interest within the meaning of section 363; therefore, the bankruptcy court could not order a sale free and clear of that contribution rate.

The bankruptcy court disagreed, and the panel affirmed. The panel adopted the expansive definition of "interest" advanced by the Second, Third, Fourth, and Seventh Circuit Courts of Appeals as more consistent with the language of the Bankruptcy Code and the policy set forth in section 363.

> We therefore conclude that the term 'any interest' as used in § 363(f) is sufficiently elastic to include the Debtor's experience rate. Indeed, the record reflects that the transfer of an employer's contribution rate to a successor asset purchaser is really an attempt to recover the money that the predecessor employer would have paid if it had continued in business.

As a result, section 363(f) permitted the court to authorize the sale free and clear of the debtor's high contribution rate. *PBBPC* is consistent with other decisions denying the transfer of a debtor's employee contribution rate to its successor. See *In re USA United Fleet, Inc*., 496 B.R. 79 (Bankr. E.D.N.Y. 2013) (Department of Labor's attempt to apply debtor's experience rating to purchaser of assets from bankruptcy trustee was inappropriate, and assets were transferred free and clear of that interest);

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In re Tougher Indus., 2013 Bankr. LEXIS 1228 (Mar. 27, 2013) (debtor's experience rating is an "interest" in property, and such property can be sold free and clear of such interest); *Ouray Sportswear, LLC v. Indus. Claim Appeals Office*, 315 P.3d 1280 (Colo. App. 2013) ("more recent trend is to read the phrase 'interest in property' broadly to include not just liens against property being sold but also claims that arose from the ownership of the property").

Conclusion

Although some may argue that the Second Circuit's *GM* decision could broaden successor liability claims even after a bankruptcy-sanctioned sale, the current trend in the cases is to protect the integrity of bankruptcy sale orders, enforcing free-and-clear language to a broad range of both claims and interests. Despite reversing the bankruptcy court's decision, the Second Circuit recognized the importance of a free-and-clear sale order as providing vast protections to a debtor who honestly and forthrightly lists all claims against it and provides notice to all such claimants consistent with due process, and for good reason: incentives are appropriate to entice parties to step in to the chapter 11 arena by purchasing assets and providing a recovery for creditors. However, free-and-clear sale orders are not without their limits: under *GM*, 829 F.3d at 159 (citing *Grogan v. Garner*, 498 U.S. 279, 286–87 (1991) (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934)), ". . . if a debtor does not reveal claims that it is aware of, then bankruptcy law cannot protect it. Courts must 'limit[] the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor.''"

Jeanne P. Darcey is a partner in Sullivan & Worcester LLP's Boston office, and head of the Bankruptcy & Restructuring Practice Group. Ms. Darcey has over 30 years of high-level and varied experience representing debtors, secured and unsecured creditors, indenture trustees and bondholders in out-of-court workouts, liquidations, creditor assignments and Chapter 11 proceedings.

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BUSINESS LAW TODAY

Top 10 Things Every Business Lawyer Should Know about Bankruptcy

By Charles M. Rubio and Freddi Mack

Every business lawyer needs a basic understanding of bankruptcy law. Your client can be affected by a bankruptcy in many ways: it may be a creditor in a bankruptcy case; it may need or want to do business with a trustee or debtor in a bankruptcy case; or it may be a defendant in a preference action or other bankruptcy litigation, among other possible scenarios. Your client also may face financial distress and need to explore restructuring or wind-down options, including filing for bankruptcy. A business lawyer needs to understand the basics to address common bankruptcy issues that arise in business matters.

Types of Bankruptcy

All bankruptcies are governed by title 11 of the United States Code. There are several types of bankruptcies available under title 11. Businesses are eligible to file under either Chapter 7 or Chapter 11. Chapter 7 is a liquidation case, which may be a good option if your client wants to cease doing business. Chapter 11 is a reorganization case, which is applicable if your client wants to maintain control and continue operating while restructuring its balance sheet. While Chapter 11 is known as a "reorganization" case, many Chapter 11 bankruptcy cases end in liquidation or in a sale of the business to a third-party purchaser.

When a debtor files a Chapter 7, a Chapter 7 trustee is automatically appointed to administer the debtor's property. Whereas, in a Chapter 11 case, the debtor generally remains in possession of its property (unless a party seeks to have a trustee appointed based on a finding by the court of fraud and mismanagement). The Chapter 11 debtor is known as a "debtor in possession." If the debtor is a business, this means that the managers of the business continue to operate the business. But because the debtor in possession has the same rights and obligations as a bankruptcy trustee, the debtor in bankruptcy has different fiduciary responsibilities than it would outside of bankruptcy. The debtor in possession in not just accountable to its equity holders, but also accountable to its creditors.

Automatic Stay

The filing of the bankruptcy case imposes an automatic stay against collection efforts on the debtor or the debtor's property. This means that while the automatic stay is in effect, creditors cannot sue, assert a deficiency, repossess property, or otherwise try to collect from the debtor. Creditors cannot demand repayment from the debtor. Creditors who violate the stay can be required to pay actual and punitive damages and attorney's fees.

The automatic stay is very broad and does not only apply to collection efforts, but also to any act to obtain possession of the debtor's property or exercise control over the debtor's property. The purpose of the automatic stay is to give the debtor a breathing spell to stop collection efforts and to permit the debtor an opportunity to attempt repayment or reorganization. However, under certain circumstances, such as a showing of good cause, creditors can ask the bankruptcy court to lift the stay. Additionally, secured creditors may ask the bankruptcy court for adequate protection from a decrease in the value of its collateral to ensure they are not unfairly prejudiced by the stay.

Proof of Claim

Creditors can assert a claim against a debtor by filing a proof of claim. A proof of claim is an official bankruptcy form that must be used. The proof of claim form recently changed, effective April 1, 2016, and can be found on the United States Courts website. A bankruptcy case will have a set deadline for when proofs of claim must be

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filed, referred to as a "bar date." Any claims not filed by this deadline are barred from being asserted at a later time

The Bankruptcy Code requires creditors to file a proof of claim if their right to payment from the debtor is contingent, unliquidated, or unmatured, except under certain circumstances. A creditor's basis for filing a proof of claim could arise from contract rights with the debtor, tort claims against the debtor, a judgment against the debtor, or even a not-yet-filed lawsuit against the debtor. The debtor will be given the opportunity to dispute the proof of claim before the bankruptcy court "allows" the claim—i.e., finds that the creditor is entitled to payment.

Meeting of Creditors

Shortly after the commencement of a bankruptcy case, the court schedules a meeting of creditors whereby creditors are invited to attend the meeting to ask questions of the debtor under oath. This meeting, called the "341 meeting" for the section of the Bankruptcy Code authorizing the meeting, is similar to a traditional deposition. The scope of the 341 meeting, however, is not governed by traditional discovery rules. Instead, the questions mostly will be about the debtor's assets, income, and debts.

Questions may be asked by the creditor directly, or by its representative. The meeting of creditors is a great opportunity for a creditor to find out information about the bankruptcy case without the need for formal discovery. Recognize, however, to the extent that the creditor has substantial and numerous questions or if the questions do not relate to the debtor's financial affairs, then the creditor's questions may be limited.

Priority of Payments

The Bankruptcy Code specifies the order in which claims are paid from the assets of a debtor's estate. Secured creditors are paid from the collateral securing their claims. Superpriority claims are generally certain types of administrative claims. Some superpriority claims prevail over secured claims while others are paid after secured claims but before priority claims. Priority claims are certain pre-petition unsecured claims that include, among other things, certain wage claims and tax claims. General unsecured claims are paid after priority claims.

If there are insufficient assets to pay all claimants of a particular priority class in full, then distributions to pay claims of the same priority class are made on a pro rata basis. This means all creditors of the same priority class are treated alike. Equity does not get paid unless all creditors are paid in full.

Discharge

A bankruptcy discharge releases the debtor from liability for certain specified types of debts which means that the debtor is no longer legally required to pay such debts. In a Chapter 7 case, the bankruptcy court generally grants the discharge promptly on expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case for substantial abuse (60 days following the first date set for the 341 meeting). In a Chapter 11 case, a discharge is granted when the Chapter 11 plan is confirmed. However, if the Chapter 11 plan provides for the liquidation of the debtor's property, then no discharge is granted.

Making collection demands on discharged debtor violates the order granting discharge and the creditor can be liable for damages and sanctions.

Executory Contracts

If your business client is a landlord or a tenant, a personal property lessor or lessee, a service provider, or a business that requires services to be provided, then issues about executory contracts are likely to arise. Executory contracts are contracts where material nonmonetary obligations have yet to be performed. The Chapter 7 trustee or debtor in possession has special rights with respect to executory contracts and leases. Specifically, they can decide whether to perform or refuse to perform under an executory contract or lease. Deciding to perform is known as assumption, and refusing to perform is known as rejection. Until the decision to assume or reject is made (or the contract is otherwise rejected by operation of the Bankruptcy Code), the counterparty must continue to perform under an executory contract or lease or be deemed to be in violation of the automatic stay. Counterparties to an executory contract, however, must be paid for goods or services provided under the executory contract during the Chapter 11 case until the executory contract is rejected.

Rejection is treated like a material breach of the contract; however, the only remedy for the counter-party is to assert a claim for rejection damages, which is treated as a pre-petition general unsecured claim, in *pari passu* with the debtor's other pre-petition general unsecured claims.

Creditors' Committees

In a Chapter 11 case, the U.S. Trustee can appoint an official committee of general unsecured creditors which is commonly known as the "creditors' committee." The creditors' committee is comprised of a representative cross-section of the debtor's unsecured creditors and has a fiduciary duty to all unsecured creditors to maintain the estate's value, consults with the debtor in possession on administration of the case, investigates the debtor's conduct and operation of the business, and participates in formulating a plan. Attorneys and other professionals retained by the creditors' committee are compensated from assets of the debtor's estate. Individual committee members are not charged directly.

The creditors' committee's role includes, among other things, providing access to information to creditors not appointed to the committee. So the creditor's committee is a great source of information for creditors in a Chapter 11 bankruptcy case. The creditor's committee is also charged with soliciting and receiving comments from creditors not appointed to the committee. Cost-conscious creditors may be able to piggy-back on work performed by the creditor's committee, such as by joining in an objection filed by the committee, to protect their positions.

Chapter 11 Plan

The Chapter 11 plan is the culmination of the Chapter 11 process and is considered a

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binding agreement between the debtor and all of its creditors and stakeholders. The debtor in possession has a certain exclusivity period where it alone can propose a plan; after that period, other creditors can propose their own plan.

The Chapter 11 plan provides the details for the debtor's reorganization or liquidation including, among other things, the treatment of all claims and interests in the debtor. The treatment of claims can vary widely from distributing cash to the claim holder, converting the claim to equity (or some other interest), or simply canceling out the debt.

With some exceptions, creditors are generally entitled to vote on the Chapter 11 plan. These creditors (or their counsel) will receive a solicitation package that includes a disclosure statement. A disclosure statement is a prospectus-like document that provides relevant background information and summarizes the major terms of the Chapter 11 plan. The solicitation package will also include a ballot to vote on the plan. If the Chapter 11 plan is approved by the bankruptcy court, then the plan is binding on all creditors and stakeholders.

If a creditor wants to object to a Chapter 11 plan, it is not sufficient to just vote against the plan. The creditor must file an objection and state the specific basis for the objection.

Preferences

Preferences are certain transfers of a debtor's property made by an insolvent debtor within 90 days of bankruptcy (or one year, if to an insider). Preferences are transfers made by the debtor on account of an antecedent debt. This means that even though the debtor owed a debt to the creditor, the creditor may have to pay the amount back as a preference. The purpose of the preference action is to prevent the debtor from preferring certain creditors' claims over others just before the bankruptcy filing—or to prevent one creditors from demanding payment on the eve of the debtor's bankruptcy to the other creditors' detriment. Instead, through preference actions, the bankruptcy court attempts to provide equality of distributions among all the creditors.

A creditor sued for a preference has many possible defenses. The creditor may defend the preference by showing, among other things: (1) that the transfer was in the ordinary course of financial affairs between the debtor and the creditor, (2) the transfer was made according to ordinary business terms, (3) the transfer was a contemporaneous exchange of value, or (4) that the creditor gave new value to the debtor after the creditor received the preferential transfer.

Conclusion

The Bankruptcy Code's substance and procedure may be foreign territory for business clients and lawyers alike. It is best to consult a bankruptcy practitioner for insight into your client's specific facts and circumstances. But every business lawyer should have at least a basic understanding of the core bankruptcy concepts. For a more detailed look at these concepts, the ABA Business Law Section hosted an "In the Know" webinar, co-sponsored by the Business Bankruptcy Committee, on June 30, 2016, titled *Bankruptcy Basics: What Every Business Lawyer Needs to Know About the Bankruptcy Process*. The speakers discussed the fundamentals of bankruptcy practice for business lawyers including details on the bankruptcy process; how the bankruptcy process impacts various parties in interest and the basics of bankruptcy litigation. Access the webinar archive here.

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BUSINESS LAW TODAY

The Interplay between Corporate Governance Issues and Litigation: What Is Corporate Governance and How Does It Affect Litigation?

By H. Stephen Grace, John E. Haupert, and Susan Koski-Grafer

The term "corporate governance" appears regularly in the news media, regulatory pronouncements, and business literature, but it is seldom explicitly defined in the contexts in which it is used. Speaking broadly, one can easily say that, "corporate governance refers to the way that a corporation or other organization is governed." However, given that it is not sufficient to use a term to define itself, and that this answer leaves open the question of what is encompassed by "governed," we begin this article with the following two definitions culled from the many reference sources available.

Source 1: Investopedia

Corporate governance is the system of rules, practices, and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government, and the community. Given that corporate governance also provides the framework for attaining a company's objectives, it encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

Source 2: Wikipedia

Corporate governance broadly refers to the mechanisms, processes, and relations by which corporations are controlled and directed. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and include the rules and procedures for making decisions in corporate affairs. Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory, and market environment. Governance mechanisms include monitoring the actions, policies, practices, and decisions of corporations, their agents, and affected stakeholders. Corporate governance practices are affected by attempts to align the interests of stakeholders.

What these two definitions and many others have in common is the concept that corporate governance relates to *the ways in which an organization is structured, overseen, managed, and operated,* and we will use this concept as our working definition.

Whether broadly or narrowly defined, corporate governance issues often lay at the heart of complex commercial litigation that seeks to establish fault and responsibility for losses, or more technically, litigation that seeks to determine liability, causation, and damages. The adequacy of the structures and processes in an organization and the business conduct of its board, management, and employees can have a significant effect on the outcome of a business dispute. This article will discuss the interplay of corporate governance issues with both plaintiff and defendant strategies in litigation, and describe how governance issues affected the ability of litigants and their counsel to prevail in three actual cases.

Three Case Histories Where Governance Practices Affected the Outcome

In the first case, a bank was alleged to have, and did have, liability issues in connection with its role as indenture trustee for bonds acquired by a special-purpose investment

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fund established by a public employees retirement system. In preparation for the trial, the bank's litigation team and its engaged expert examined both the defendant bank's governance processes and the governance processes of the plaintiff retirement system and its special-purpose fund. Although the bank-defendant did have some missteps in its own operations and other governance issues, examination of the retirement system's governance processes and actions identified conflicts of interest and weaknesses and errors in their operations, as well as flaws in their damage model, all of which impacted the outcome of the litigation.

In the second case, a plaintiff oil company sued a defendant oil company under a letter agreement and operating agreement relating to the purchase and operation of an oil field. The plaintiff contended that the defendant, as the operator, had intentionally hindered the plaintiff's efforts to participate and had injured plaintiff as a result by lowering its stock price in a subsequent public offering. The defendant's expert team examined the business conduct of both the defendant and the plaintiff and raised issues about the actions and allegations of the plaintiff. The findings of this examination influenced the conclusion of the matter.

In the third case, the U.S. Securities and Exchange Commission (SEC) sued the CEO of a software company, claiming that the CEO had intentionally caused the misstatement of his firm's financial statements through an accounting fraud stemming from various operational and revenue recognition decisions. The defendant CEO expert team reviewed the detailed allegations against a customary understanding of a CEO's roles and duties and reported on the appropriateness of the CEO's conduct, all of which contributed to a satisfactory resolution of the litigation.

Case I: Damage Claim by a Public Employees' Retirement System against a Bank as Indenture Trustee

A major public employees' retirement system attributed losses incurred on investments by its special-purpose fund in debentures of a savings and loan association (S&L) that later failed to the inadequate performance by a bank serving as an indenture trustee, and sued the bank, XBank.

The retirement system asserted that the indenture trustee, XBank: (1) failed to thoroughly examine the borrower's certifications and other documents submitted in accordance with the indenture; (2) failed to trigger a default when the borrower did not deliver various documents in a timely manner as called for under the indenture; (3) failed to have a working "follow-up" system and training programs to support the indenture trustee; and (4) had been negligent and had breached its fiduciary duties to the retirement system.

XBank and other defendants faced an adverse and high stakes legal situation that involved: (1) assertions of actual calculated damages in excess of $200M with additional prejudgment interest of 10 percent due for several years; (2) an extremely adverse venue, given that the plaintiff's retirement recipients likely would comprise approximately 80 percent of any jury in the venue where the trial was to occur; (3) a state legislature that had been loath to raise taxes to correct any shortfall in the investment fund; and (4) a decision by the state supreme court that had overruled 75 years of prior jurisprudence to affirm that the case would be tried in state court in the state capitol, a location that contained the highest percentage of current and potential recipients of benefits from the retirement system.

The bank's litigation team (law firm and a consultant/expert firm) found that XBank did have deficiencies with systems and the training of its corporate indenture trustees. Further, in the case of one of the three defaults alleged regarding the failure of required officer's certificates to be timely received, it was true that the documents were received outside of the specified cure period. However, the analysis conducted by the defendant bank's litigation team established that the indenture trustee had neither the obligation nor the factual basis to call a default when these delays occurred. Timeliness is seldom a sole basis for triggering a business-driven default, and a review of documents made it clear that the S&L was in good financial condition at the time the documents were received outside of the cure period. The defendant litigation team also found that other allegations of bank negligence and mismanagement were contradicted by the facts.

Interestingly, and oftentimes an area that is not fully examined, the team's analysis of the environment surrounding the business and personal dealings of relevant persons on the *plaintiff side* revealed that the chair of the retirement system had engaged in serious conflicts of interest that tainted the decision-making process, which led to the initial and subsequent investments made by the retirement system's special-purpose fund in the S&L that failed. Further, the retirement system had numerous flaws in their own internal management and investment processes that contributed significantly to their losses. The special-purpose fund was focused on a broad range of "alternative" investments, and it was acknowledged in deposition that they lacked the required experience to manage these investments. Further, the defendant litigation team established that the special-purpose fund's cash flows were retained and reinvested in their pool of investments, and 90 percent of their original capital had been lost in so doing. This finding basically undermined their $200 million damage claim because it pointed out that, had XBank returned the principal, 90 percent of it would have been subsequently lost.

The result in this case was that, upon presentation of XBank's key evidence in mediation, including information about weaknesses in the plaintiff's governance practices, the retirement system elected to dismiss its case against XBank. The retirement system continued their litigation with the other defendants and was successful in collecting from every other defendant, with total collections approximating $100M.

Case II: Breach of Letter Agreement and Operating Agreement

Plaintiff ABC oil company sued defendant XYZ oil company under a letter agreement and operating agreement involving the purchase and subsequent operation of an oil field. ABC contended that XYZ, the opera-

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tor, had intentionally hindered ABC's efforts to participate in development of the field by various actions, including failure to provide access to data in breach of both the letter agreement for purchase of the field and the operating agreement. ABC asserted that the resulting delay in development of the field allegedly caused by defendant XYZ's actions had injured ABC by lowering its stock price in a subsequent public offering. XYZ retained an expert team to analyze these allegations and the damages calculated by ABC's expert.

The expert team consisted of four senior executives with energy-related experience. Using available information on the financial and operational condition of both XYZ and ABC, and drawing upon their extensive knowledge of the oil and gas industry and financial experience in damage calculation, the expert team concluded:

1. Plaintiff ABC Oil Company was in dire financial straits and was not capable of financing the proposed development program.
2. Defendant XYZ Oil Company had operated in a manner that benefitted both ABC and XYZ.
3. Plaintiff ABC expert's stock pricing model damage calculation based on historic cash flows violated generally accepted valuation techniques and ignored accepted factors used in valuation, e.g., the timing and amount of future cash flows.

The result in this case was that, after extensive discovery, including production of expert reports and depositions, the plaintiff filed an amended petition basically eliminating the allegations challenged by the expert team. A satisfactory settlement was reached.

Case III: Securities Fraud Claim under the 1934 Act

The SEC sued the CEO of a software company claiming that the CEO had intentionally orchestrated the misstatement of the company's financial statements through an accounting fraud, which ultimately resulted in a restatement. The SEC further asserted that the CEO's certification of the restated financial statements was an admission of wrongdoing. The CEO and his counsel retained an expert team to analyze these allegations and those of the SEC's expert witness.

Drawing upon their extensive experience as officers and board members of major corporations, persons who have actually been involved in business decision-making and internal reporting processes, and in managing the preparation and issuance of corporate financial statements, the expert team was able to review and evaluate these detailed allegations and explain what the CEO's role and duties were in this situation. Specifically, the expert report explained:

1. All companies must rely on a division of labor to operate.
2. By necessity, the CEO must rely on the expertise of others within the company to fulfill his duties and obligations in his role in the overall management of the company.
3. The proper accounting for transactions under GAAP is not always a black-and-white issue and requires accounting expertise.
4. The CEO was not an expert in accounting and had the right, in this instance which involved complicated accounting issues not fully resolved by the accounting rules, to rely on the accounting judgment of both internal and external accounting professionals as to the proper way to account for the transactions in question.
5. The CEO had not ignored his duties, but rather had performed those duties by seeking the advice of internal and external professionals in an effort to fulfill his obligations.

The SEC in this case had originally sought: (1) a permanent injunction; (2) civil penalties; (3) an officer and director bar; and (4) other relief. The result was that, following the pretrial conference with the judge the day before trial was to begin, in which information was shared regarding the CEO's conduct and customary expectations and practices relating to CEO responsibilities, the matter was settled for a nominal five-digit amount.

The Impact that Corporate Governance Issues Can Have in Litigation

In each of these cases, the corporate governance structure and policies, and the business practices and processes that had been carried by all parties involved in the litigation, were identified in a comprehensive and systematic analysis utilizing the business knowledge of expert reviewers. Having such direct business knowledge was an important factor in the reviews, as there is no single, agreed-upon formula or approach to the details of corporate governance processes and procedures in a particular organization, and the division of labor in any entity is specific to that individual organization at a point in time. Consequently, an effective assessment and evaluation of the decision-making and oversight processes used, and actions taken in a disputed matter, must take into account what information was known or available to decision-makers at the point in time involved, and recognize that good business decisions based on well-accepted business practices and processes can nevertheless sometimes have bad outcomes. To avoid hindsight bias, it is necessary to examine and understand the corporate governance structures of, and the processes and procedures that were carried out by, litigant parties and assess whether and how these processes and actions caused or contributed to any losses claimed. *This identification of whether and how a litigant's governance processes and action(s) impacted matters under dispute is the interplay of corporate governance issues and litigation.*

The interplay may extend to multiple parties directly and indirectly involved in the litigation. In two of the cases described in this article, the assessment of governance issues facing the plaintiffs identified improper actions on their part to the point that these other parties were actually responsible for the damages they had, or allegedly had, experienced. In the third case, corporate governance issues in the form of usual and cus-

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tomary and acceptable practices expected of CEOs provided a sufficient defense to the SEC allegations to result in a substantial reduction in the assessed penalty.

Although the cases in this article involved public companies and addressed corporate governance processes in publicly listed companies, the interplay of governance processes and litigation can affect organizations of all forms and sizes.

An additional insight that can be gleaned from these three cases is the importance of an organization having well-structured, viable business processes that drive proper business conduct, not just for litigation reasons, but for more effective operations as well. The bank was at risk because of its flawed processes; however, the retirement system had its own flawed processes. The plaintiff oil company's conditions and processes undermined its allegations. The software company's appropriate internal processes, when carefully examined, helped to carry the day to a beneficial outcome. In all of these situations, it is quite possible that having better governance and better processes might have avoided or minimized losses or decreased the likelihood of litigation in the first place.

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BUSINESS LAW TODAY

Entity Lifecycles: An Overview of the Statutory Requirements Relating to the Formation, Maintenance, and Termination of Delaware Corporations, Limited Liability Companies, and Statutory Trusts

By Shannon S. Frazier

When starting up a company, forming a subsidiary, or creating an investment vehicle, selecting a business entity is one of the most significant decisions made by business lawyers and their clients. Delaware generally is recognized as the premier jurisdiction for business formation, and there is a variety of entities available under Delaware law. Different types of business entities, each with different characteristics, may be formed to achieve the client's business goals and to organize the relationship among the business's owners, creditors, and management. The various forms available in Delaware include, among others, corporations (including pubic benefit corporations), limited liability companies, and statutory trusts.

For a variety of reasons and entirely depending on the goals of the organization, these three entity types are those most often selected. For instance, if the parties intend that all of the profits be retained by the entity for growth purposes, or if the ultimate plan is to take the entity public, then a corporation may be the best entity choice. Similarly, if the parties are engaging in a structured finance transaction, such as the securitization of assets or project or equipment finance, a statutory trust may be best suited to meet their needs. Likewise, if the goal is flexibility in the structuring of the entity, a limited liability company may be the best option. The avoidance of double taxation can be accomplished in both the limited liability company and corporate context, however, and a real estate financing transaction that requires a special-purpose entity may utilize either a statutory trust or a limited liability company. Furthermore, if the entity has, for instance, a strong charitable, artistic, environmental, religious, social, or similar focus or mission, a public benefit corporation might be the logical choice. It is therefore imperative to the selection process that all parties involved possess a basic understanding regarding the formation, maintenance, and termination of each of these three entity types. Although certainly not your exclusive source of information, the first place to gain this requisite understanding is the Delaware Code. The Delaware General Corporation Law, Del. Code Ann. tit. 8, §§ 101–619 (the DGCL), the Delaware Limited Liability Company Act, Del. Code Ann. tit. 6, §§ 18-101–18-1109 (the LLC Act), and the Delaware Statutory Trust Act, Del. Code Ann. tit. 12, §§ 3801–63 (the DST Act), all set forth the fundamental requirements for establishing, maintaining, and terminating these entities.

Formation of Delaware Corporations

Under sections 101(a) and 362 of the DGCL, a corporation (including a public benefit corporation) may be organized in the state of Delaware by filing a certificate of incorporation with the Office of the Secretary of State of the State of Delaware (the Delaware Secretary of State). The certificate of incorporation must set forth the information required by section 102 (and, in the case of a public benefit corporation, the additional information required by section 362) and must be executed, acknowledged, and filed in accordance with section 103.

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Corporate existence commences under section 106 upon the filing of the certificate of incorporation (or at such later time as may be specified in such certificate of incorporation).

Further, every Delaware corporation (including a public benefit corporation) must have a registered office (which may, but need not be, the same as its place of business) and a registered agent for service of process in the state of Delaware (a Registered Agent) under sections 131–32. Such Registered Agent shall have agreed (in advance of its designation as such in the certificate of incorporation) to accept legal papers on the corporation's behalf if it is sued, and such Registered Agent must meet the requirements of section 132.

Following the filing of the certificate of incorporation, the incorporator (or the initial directors named in the certificate of incorporation) may perfect the organization of the corporation under sections 108–09 by appointing directors (if not already named in the certificate of incorporation) and adopting bylaws.

Formation of Delaware Limited Liability Companies

Under section 18-201 of the LLC Act, a limited liability company may be organized in the state of Delaware by filing a certificate of formation with the Delaware Secretary of State. The certificate of formation must set forth the information required by section 18-201(a) and must be executed by an "authorized person" in accordance with section 18-204. Limited liability company existence commences upon the filing of the certificate of formation (or at such later time as may be specified in such certificate of formation).

In addition, a limited liability company agreement shall be entered into or otherwise existing either before, after, or at the time of the filing of the certificate of formation and may be made effective as of the effective time of such filing or at such other time or date as provided in the limited liability company agreement. Moreover, each limited liability company must have at least one person admitted as a member at the time of the filing of the certificate of formation under section 18-101(6).

As is the case with Delaware corporations, every Delaware limited liability company must have a Registered Agent. Such Registered Agent shall have agreed (in advance of its designation as such in the certificate of formation) to accept legal papers on the limited liability company's behalf if it is sued, and such Registered Agent must meet the requirements of section 18-104.

Formation of Delaware Statutory Trusts

Under section 3810 of the DST Act, a statutory trust may be organized in the state of Delaware by filing a certificate of trust with the Delaware Secretary of State. The certificate of trust must set forth the information required by section 3810(a)(1) and must be executed by all of the trustees of the trust in accordance with section 3811(a). Trust existence commences upon the filing of the certificate of trust (or at such later time as may be specified in such certificate of trust).

In addition to the certificate of trust, a governing instrument—that is, any written instrument, whether referred to as a trust agreement, a declaration of trust, or otherwise, which creates the statutory trust or provides for the governance of the affairs of the statutory trust and the conduct of its business—shall be entered into at or prior to the time of filing of the certificate of trust under section 3801(g).

Further, under section 3807(a), every Delaware statutory trust shall at all times have at least one trustee which, in the case of a natural person, shall be a person who is a resident of the state of Delaware or which, in all other cases, has its principal place of business in the state of Delaware.

Regardless of which entity type is selected, there are a few practical items that parties forming these entities may want to keep in mind. First, in Delaware and in many other states, it is possible to reserve an entity name in advance of formation. It is generally recommended to reserve your chosen name not only in Delaware, but also in each other state where you wish the entity to conduct business to avoid the need to amend your formation and transaction documents should the name be unavailable in one of the selected jurisdictions. Second, it is important to take a close look at how you have named your entity. Each of the three statutes has words that you must (or may not) use in the name of your entity. Having the Delaware Secretary of State reject your filing for improper naming protocol reflects poorly on the practitioner and leads to increased costs. It is also important to remember that your entity name does not equate to trademark protection—if you plan to use a name in trade, you should check the trademark register.

Public Filings Generally

The Delaware Secretary of State is the appropriate office for entity-related filings for all three of the subject Delaware entity types. Under the DCGL and LLC Act, unless the names of the directors/officers (in the case of a corporation, including a public benefit corporation) or the members/managers (in the case of a limited liability company) are set forth in the certificate of incorporation or certificate of formation, as the case may be, no amendments are required to such certificate(s) in connection with changes to the identities of the persons holding those positions. When dealing with a Delaware statutory trust, the certificate of trust must be amended to reflect changes to the name or address of the trustee and/or to correct any inaccuracy set forth therein. Likewise, the certificate of incorporation of a Delaware corporation or the certificate of formation of a Delaware limited liability company, as the case may be, must be amended to reflect changes to the name or address of the Registered Agent and/or to correct any inaccuracy set forth therein.

As a practical matter, one of the many benefits of utilizing a Delaware entity is the limited public disclosure requirements. Specifically, none of the subject entities are required under Delaware law to disclose in any public filing with the Delaware Secretary of State the names or other personal information of their equity or beneficial owners. Delaware corporations (including public benefit corporations) are required

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each year to file with the Delaware Secretary of State annual reports (together with their required annual franchise tax payments), which must list: (1) the company's physical address (not a P.O. box and not the corporation's Registered Agent's address); (2) the name and physical address of at least one director; and (3) if there are any officers, the name, title, and physical address of at least one of the officers. Delaware limited liability companies, although obligated to pay franchise taxes to the state of Delaware each year, do not have annual reporting requirements.

Books and Records

As indicated above, each of the three Delaware entities requires designation of a Registered Agent or a trustee (as applicable) in the relevant entity filing made with the Delaware Secretary of State, and this information must be kept up to date in the Delaware Secretary of State filing system. Further, even though the DGCL, the LLC Act, and the DST Act do not require any other public filing to be made in the state of Delaware in respect of stock ownership or membership or beneficial interest ownership, as the case may be, this information should nonetheless be kept up to date in the internal books and records maintained with respect to each Delaware registered legal entity.

Delaware Corporations

With respect to Delaware corporations, in addition to the certificate of incorporation and bylaws, the following books and records should be maintained (note, however, that this is not an exclusive list):

1. stock ledger
2. list of stockholders
3. stockholder agreements, option agreements, and documents of similar import
4. records of board (and committee) meetings and action
5. records of stockholder meetings and action, including, in the case of a public benefit corporation, copies of the biennial statements to stockholders as to the corporation's promotion of the public benefit stated in its certificate of incorporation and of the best interests of those materially affected by the corporation's conduct, all as required by section 366 of the DGCL
6. financial records and ledgers
7. copies of annual reports filed with the Delaware Secretary of State (together with Delaware franchise tax receipts)
8. any other information deemed necessary or convenient by the officers and/or directors.

Delaware Limited Liability Companies

With respect to Delaware limited liability companies, in addition to the certificate of formation and limited liability company agreement, the following books and records should be maintained (note, however, that this is not an exclusive list):

1. membership interest ledger
2. list of members
3. records of manager (and committee) meetings and action
4. records of member meetings and action
5. financial records and ledgers
6. copies of Delaware franchise tax receipts
7. any other information deemed necessary or convenient by the managers and/or members.

Delaware Statutory Trusts

With respect to Delaware statutory trusts, in addition to the certificate of trust and governing instrument of the trust, the following books and records should be maintained (note, however, that this is not an exclusive list):

1. beneficial interest ledger
2. list of beneficial owners
3. records of trustee meetings and action
4. records of beneficial owner meetings and action
5. financial records and ledgers
6. any other information deemed necessary or convenient by the trustee and/or beneficial owners.

Management Structure, Requirements, or Restrictions

Unlike other jurisdictions, the DGCL, the LLC Act, and the DST Act do not impose a maximum number of directorship, managerial, or trustee roles (as applicable) any one natural person or business entity can hold. However, each of the three entity statutes does set general parameters for the management of each entity.

Delaware Corporations

Under section 141(b) of the DGCL, the board of directors of a Delaware corporation (including a public benefit corporation) must be comprised of at least one member, each of whom shall be a natural person. Directors are not required to be stockholders unless so mandated by the certificate of incorporation or the bylaws, and the certificate of incorporation or bylaws may also prescribe other qualifications for directors. The number of directors shall be established by, or in the manner provided in, the bylaws, unless the certificate of incorporation establishes the number of directors, in which case a change in the number of directors requires an amendment to the certificate of incorporation. Practically speaking, unless you are dealing with a closely held corporation (where getting the necessary stockholder consent to amend the certificate of incorporation will be straightforward), or there are specific business reasons to set forth the number of directors in the certificate of incorporation, it is generally not recommended to put this provision in the certificate of incorporation. Limiting this information to the bylaws allows the corporation to be a bit more flexible and nimble when it comes to board composition.

As a general rule, a majority of the total number of directors of a Delaware corporation (including a public benefit corporation) shall constitute a quorum for the transaction of business unless the certificate of incorporation or the bylaws require a greater number. Unless the certificate of incorporation provides otherwise, the bylaws may provide that a number less than a majority constitutes a quorum, but in no instance may that number be less than one-third of the total

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number of directors (except in the circumstance where a board is comprised of a single director, in which event that one director constitutes a quorum). The vote of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors unless the certificate of incorporation or the bylaws shall require a vote of a greater number.

Pursuant to section 141(c)(2) of the DGCL, the board of directors of a Delaware corporation (including a public benefit corporation) may, by resolution or in the bylaws, designate one or more committees, each consisting of one or more of the directors of the corporation. Any such committee, to the extent provided in the resolution or in the bylaws, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it, but no such committee shall have the power or authority in reference to the following matters: (1) approving or adopting, or recommending to the stockholders, any action or matter (other than the election or removal of directors) expressly required by the DGCL to be submitted to stockholders for approval; or (2) adopting, amending, or repealing any bylaw of the corporation.

Moreover, other than as may be set forth in the bylaws of the Delaware corporation (including a public benefit corporation), there is no DGCL requirement regarding the occurrence or frequency of meetings of the directors. However, section 211(b) of the DGCL requires that, unless directors are elected by written consent in lieu of an annual meeting, an annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws.

Delaware Limited Liability Companies

Under section 18-402 of the LLC Act, unless otherwise provided in the limited liability company agreement, the management of a Delaware limited liability company shall be vested in its members in proportion to the then-current percentage or other interest of members in the profits of the limited liability company owned by all of the members; *provided, however*, that if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager who shall be chosen in the manner provided in the limited liability company agreement. The manager shall also hold the offices and have the responsibilities accorded to the manager by or in the manner provided in a limited liability company agreement. A limited liability company may have more than one manager.

Under section 18-404(c), a limited liability company agreement may set forth provisions relating to notice of the time, place, or purpose of any meeting at which any matter is to be voted on by any manager or class or group of managers, waiver of any such notice, action by consent without a meeting, the establishment of a record date, quorum requirements, voting in person or by proxy, or any other matter with respect to the exercise of any such right to vote. Further, under section 18-407, unless otherwise provided in the limited liability company agreement, a member or manager of a limited liability company has the power and authority to delegate to one or more other persons the member's or manager's, as the case may be, rights and powers to manage and control the business and affairs of the limited liability company, including to delegate to agents, officers, and employees of a member or manager or the limited liability company, and to delegate by a management agreement or another agreement with, or otherwise to, other persons. Although not expressly required by statute, best practices dictates that records of such delegations be maintained in the books and records of the limited liability company.

The LLC Act contains no requirement, other than as may be set forth in the limited liability company agreement, for holding annual or periodic meetings of the managers or members of the Delaware limited liability company.

Delaware Statutory Trusts

As previously mentioned, under section 3807(a) of the DST Act, every Delaware statutory trust shall at all times have at least one trustee which, in the case of a natural person, shall be a person who is a resident of the state of Delaware or which, in all other cases, has its principal place of business in the state of Delaware. Further, except to the extent otherwise provided in the governing instrument of the Delaware statutory trust, the business and affairs of such statutory trust shall be managed by or under the direction of its trustees. To the extent provided in the governing instrument of a statutory trust, any person (including a beneficial owner) shall be entitled to direct the trustees or other persons in the management of the Delaware statutory trust under section 3806(a).

Under section 3806(b)(5), a governing instrument of a Delaware statutory trust may contain any provision (not inconsistent with law or the provisions of the certificate of trust) relating to the management of the business and affairs of the trust and the rights, duties, and obligations of the trustees, beneficial owners, and other persons, and may, if and to the extent that voting rights are granted under the governing instrument, set forth provisions relating to notice of the time, place, or purpose of any meeting at which any matter is to be voted on, waiver of any such notice, action by consent without a meeting, the establishment of record dates, quorum requirements, voting in person, by proxy or in any other manner, or any other matter with respect to the exercise of any such right to vote.

Pursuant to section 3806(i), except to the extent otherwise provided in the governing instrument of a Delaware statutory trust, a trustee of a Delaware statutory trust has the power and authority to delegate to one or more other persons the trustee's rights and powers to manage and control the business and affairs of such statutory trust, including to delegate to agents, officers, and employees of the trustee or the statutory trust, and to delegate by management agreement or other agreement with, or otherwise to, other persons. Although not expressly re-

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quired by statute, best practices dictate that records of such delegations be maintained in the books and records of the statutory trust.

The DST Act contains no requirement, other than as may be set forth in the governing instrument of the Delaware statutory trust, for holding annual or periodic meetings of the trustees or beneficial owners.

Dissolution

As a general matter, unless otherwise provided in the certificate of incorporation of a Delaware corporation (including a public benefit corporation) under section 102(b)(5) of the DGCL, the limited liability company agreement of a Delaware limited liability company under section 18-801(a)(1) of the LLC Act, or the governing instrument of a Delaware statutory trust under section 3808(a) of the DST Act, each of these three entities has perpetual existence. Despite this similarity, the relevant statutes do set forth different requirements and procedures for dissolution of each of the entities. It is particularly important for parties to understand the differences in the way Delaware corporations and Delaware limited liability companies are dissolved. As further discussed below, the filing of a certificate of dissolution of a Delaware corporation is the action that commences the three (3)-year winding up period; conversely, the filing of a certificate of cancellation of a Delaware limited liability company takes place following the winding up of the entity.

Delaware Corporations

Generally, the procedure for dissolution of a Delaware corporation (including a public benefit corporation) under section 275 of the DGCL requires: (1) the adoption by a majority of the board of directors of a resolution deeming dissolution advisable (in the judgment of such board of directors) and the subsequent vote in favor of dissolution by a majority of the stockholders entitled to vote thereon, or without action of the directors if all the stockholders entitled to vote thereon consent in writing to dissolution; (2) the filing of a certificate of dissolution setting forth the information required by section 275(d), which has been executed, acknowledged, and filed in accordance with section 103; and (3) the payment of any then-due franchise taxes owing to or assessable by the state of Delaware and the filing of any related annual reports.

It is important to note that a Delaware corporation (including a public benefit corporation) continues to exist for a term of three years from the time of filing of a certificate of dissolution (or for such longer period as the Court of Chancery shall direct) for the purpose of prosecuting and defending suits, whether civil, criminal, or administrative, by or against it, and of enabling it gradually to settle and close its business, to dispose of and convey its property, to discharge its liabilities, and to distribute to its stockholders any remaining assets in accordance with section 281, but not for the purpose of continuing the business for which the corporation was organized. The DCGL also sets forth in section 280 a mechanism that both permits distributions upon dissolution and avoids the risk that a future claimant would be able to establish that such distribution on dissolution was in violation of any duty owed to the corporation's creditors.

Delaware Limited Liability Companies

A Delaware limited liability company may be dissolved upon any of: (1) the time or the happening of events specified in the limited liability company agreement; (2) unless otherwise provided in the limited liability company agreement, the affirmative vote or written consent of the members of the limited liability company or, if there is more than one class or group of members, then by each class or group of members, in either case, by members who own more than two-thirds of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members or by the members in each class or group, as appropriate; or (3) the entry of a decree of judicial dissolution under section 18-802 of the LLC Act. Further, a Delaware limited liability company may be dissolved at any time there are no members, *provided that* the Delaware limited liability company is not dissolved and is not required to be wound up if the criteria set forth in section 18-801(a)(4) are met.

Upon dissolution of a Delaware limited liability company in accordance with section 18-801, and until the filing of a certificate of cancellation as provided in section 18-203(a), the persons winding up the limited liability company's affairs under section 18-803(b) may, in the name of and for and on behalf of the limited liability company, prosecute and defend suits, whether civil, criminal, or administrative; gradually settle and close the limited liability company's business; dispose of and convey the limited liability company's property; discharge or make reasonable provision for the limited liability company's liabilities; and distribute to the members any remaining assets of the limited liability company.

Upon completion of the winding up process referenced above, a certificate of cancellation of the limited liability company must be filed with the Delaware Secretary of State (together with the payment of any then-due franchise taxes owing to or assessable the state of Delaware and the filing of any related annual reports), whereupon the existence of the limited liability company shall cease under section 18-203(a).

Delaware Statutory Trusts

Pursuant to section 3808(a) of the DST Act, except to the extent otherwise provided in the governing instrument of a Delaware statutory trust, a Delaware statutory trust shall have perpetual existence, and may not be terminated or revoked by a beneficial owner or other person except in accordance with the terms of its governing instrument. In the event that a Delaware statutory trust does not have perpetual existence, a Delaware statutory trust is dissolved and its affairs shall be wound up at the time or upon the happening of events specified in the governing instrument.

Upon dissolution of a Delaware statutory trust and until the filing of a certificate of cancellation as provided in section 3810(d), the persons who, under the governing instrument of the Delaware statutory trust, are responsible for winding up

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the statutory trust's affairs may, under section 3808(d), in the name of and for and on behalf of the statutory trust, prosecute and defend suits, whether civil, criminal, or administrative; gradually settle and close the statutory trust business; dispose of and convey the statutory trust property; discharge or make reasonable provision for the statutory trust liabilities; and distribute to the beneficial owners any remaining assets of the statutory trust.

Upon completion of the winding up process referenced above, a certificate of cancellation of the certificate of trust must be filed with the Delaware Secretary of State, whereupon the existence of the Delaware statutory trust shall cease under section 3810(d).

In conclusion, although many similarities exist among Delaware corporations (including public benefit corporations), Delaware limited liability companies, and Delaware statutory trusts, they are each distinct types of business entities with distinct characteristics. A thorough understanding of the essential statutory requirements for formation, maintenance, and termination of these entities provides a starting point for business decision-makers in determining which of these entities can meet the needs of the enterprise and establish the intended relationship among owners, creditors, and management.

Shannon S. Frazier is a partner in the Business Transactions, Strategic Planning and Counseling Practice of Morris James LLP. Shannon renders legal advice to Delaware business entities in the areas of formation, operation, and governance of statutory and common law trusts, limited liability companies, series entities, partnerships, and corporations, and represents banks, trustees, financial institutions, and other parties in securitization, private equity, structured finance, and secured transactions, and offers third-party legal opinions in these matters.

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BUSINESS LAW TODAY

Website Accessibility for Persons with Disabilities: The Why & How

By Meredith Mays Espino

There has been a growing conversation lately regarding website accessibility for people with disabilities. Despite the fact that nearly 20 percent of the population in the United States has a disability—nearly one in five people—website accessibility is rarely a consideration when developers create websites and apps. Adding conditions and parameters to website development costs money, but so does an inaccessible website in terms of resulting litigation and lost customers as clicks and page views are missed, inventory is not purchased, and reservations are not made. Advocacy groups want access, and businesses should want the customers. It is no surprise that litigation over accessibility filed by advocacy groups and individual users is rapidly increasing, and businesses are experiencing growing angst.

People with disabilities affected by website inaccessibility may have varying degrees of auditory, cognitive, neurological, physical, speech, and visual impairments. According to the National Federation for the Blind, there are over 7.3 million people in the United States alone who have varying degrees of blindness. The U.S. Census found over one million deaf people and over eight million who are hard of hearing. Neurological disabilities, including epilepsy, affect nearly one billion people worldwide. Color blindness in various forms affects approximately 1 in 12 men and 1 in 200 women globally.

In order to participate in the online community and in e-commerce, some people with disabilities can use assistive technologies and adaptive strategies to work around hindrances. Assistive technologies include screen readers that read webpages aloud, screen magnifiers to make text and graphics larger and easier to see, voice recognition software to assist with typing and commands, and scanning and switches systems that scan pages and allow the user to make a selection by hitting a switch. Adaptive strategies include resizing fonts, reducing mouse speeds, and using captions for audio content.

These technologies are helpful, but insufficient. They do not allow users to fully engage with webpages, precluding them from educational and commercial opportunities and social activities. Websites are simply not designed to work with these assistive tools. This issue was hot in the late 1990s and early 2000s but fizzled quickly, leaving out many users with disabilities.

Some countries passed laws and promulgated rules requiring accessibility, but the vast majority of requirements are for only governmental websites. Compliance by nongovernmental entities is regulatorily optional and often not a consideration when websites are built, leaving those with disabilities behind and leaving companies with a large, mostly untapped market.

The Americans with Disabilities Act (ADA) was passed in 1990 to prohibit discrimination and ensure equal opportunity for persons with disabilities in employment, government services, public accommodations, commercial facilities, and transportation. Although Internet service providers (ISPs) began to emerge in the late 1980s, the commercial Internet did not truly develop until the mid-1990s. The ADA did not contemplate Internet websites because the Internet was still in its nascent state when it was passed.

ADA Title III provides that, "No individual shall be discriminated against on the basis of disability in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases (or leases to), or operates a place of public accommodation." Although private clubs and religious

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organizations are excluded, the ADA does include places of exhibition and entertainment, places of public gathering, libraries, galleries, service establishments, places of recreation, and places of education.

Websites are all of these things; therefore, they are places of public accommodation, and the ADA applies to them. However, the courts have not found footing on the application of the ADA to websites. The Department of Justice, the regulator for the ADA, has brought enforcement actions against websites for lack of accessibility but has neglected to promulgate rules outlining requirements for website accessibility. The DOJ instead has been using the World Wide Web Consortium's WCAG 2.0 Guidelines as a baseline for compliance with the statute in enforcement actions. While we await the DOJs rules regarding website accessibility and a consensus among the courts, it would behoove website developers and owners to abide by the WCAG 2.0 Guidelines to avoid a trip to the courthouse or an action by the DOJ.

Accessibility According to the Courts

According to a recent study conducted by Seyfarth Shaw LLP, over 240 cases alleging inaccessibility have landed in federal court since early 2015. However, the cases have been rolling in since 2000 and show no signs of stopping. Courts disagree as to whether the ADA applies to web-based businesses. Many have determined that websites are places of accommodation and must be accessible to those with disabilities. Others have determined that there must be a nexus between the online access to services or goods complained of and a physical place.

The first major case to allege inaccessibility as a violation of the ADA was *Access Now v. Southwest Airlines*, 227 F. Supp. 2d 1312 (S.D. Fla. 2002). The plaintiffs alleged that Southwest's technology violated the ADA because the goods and services offered on its website were inaccessible to blind persons using a screen reader. The court granted Southwest's motion to dismiss, holding that the ADA covered only physical places. The plaintiffs failed to establish a nexus between the website and a physical, concrete place of public accommodation to which their access was impeded, such as a particular airline ticket counter or travel agency.

In *National Federation of the Blind v. Target Corp.*, 452 F.Supp.2d 946 (N.D. Cal., 2006), the plaintiffs alleged that blind people were unable to access much of the information on the defendant's website or make purchases from its website in violation of the ADA. The Northern District of California certified a nationwide class action and denied, in part, Target's motion to dismiss. It upheld NFB's argument that websites like Target.com must be accessible to the blind but reaffirmed the requirement that there be a "nexus" between the Internet services and a physical place in order to present an actionable ADA claim. The use of the "nexus" approach to the ADA's applicability to the Internet would cover places of business with physical stores, such as Target. However, stores such as Amazon.com that have no physical storefront may not be covered under such an approach. Further, the plaintiffs failed to state a claim under the ADA to the extent that the website offered information and services unconnected to the retailer's stores. The case eventually settled. Target agreed to make changes to the website and pay attorney's fees and costs in the amount of $3,738,864.96.

In 2012, the District of Massachusetts disregarded the theory that a brick-and-mortar store is necessary for the ADA to apply. In *National Association of the Deaf v Netflix, Inc.*, 869 F. Supp. 2d 196 (D. Mass., Jun. 19, 2012), the plaintiffs alleged that Netflix failed to provide equal access to its video streaming website for deaf and hearing-impaired individuals by offering only a limited amount of streaming content available with closed captioning. In denying Netflix's motion for summary judgment, the court held as irrelevant the fact that the ADA does not include web-based services as a specific example of a public accommodation. The court determined that Congress did not intend to limit the ADA to the specific examples listed in each category of public accommodations, and that the plaintiffs must show only that the website falls within a general category listed under the ADA. Later, Netflix signed a consent decree, agreeing to increase access for those with hearing impairment.

The 9th Circuit affirmed the stance that the ADA applies to only physical places in a case against eBay. *Earll v. eBay, Inc.*, 2015 WL 1454941 (9th Cir., Apr. 1, 2015) The plaintiff alleged that eBay's voice-based verification process prevented her from registering as a seller in violation of the ADA. The court affirmed its prior decision in *Weyer v. Twentieth Century Fox Film Corp.*, 198 F.3d 1104 (9th Cir., 2000), wherein the court determined that the ADA requires that there be some connection between the good or service complained of and a physical place.

In 2014, the National Federation of the Blind sued Scribd, an online subscription library and open publishing platform, because its website was nearly completely inaccessible to blind people. Scribd's motion to dismiss was denied. *Nat'l Federation of the Blind v. Scribd, Inc.*, 2015 WL 1263336 (D. Vt., 2015). The District of Vermont found that the test is whether the services offered by the website properly falls within any of the general categories of public accommodations listed in the statute. Scribd's services fall within the following categories: a "place of exhibition or entertainment," a "sales or rental establishment," a "service establishment," a "library," a "gallery," and a "place of public display or collection." Therefore, the plaintiffs sufficiently alleged that Scribd owns, leases, or operates a place of public accommodation. The case settled in November with Scribd agreeing to completely rewrite its site so that software used by the blind could be used on documents within the site.

Also last year, two cases were filed in the District of Massachusetts against Harvard and MIT by the National Association for the Deaf. *Nat'l Assoc. for the Deaf v. Harvard U.*, 3:15-cv-30023 and *Nat'l Assoc. for the Deaf v. Mass. Inst. of Tech.*, 3:15-cv-30024 (D. Mass, 2015). The plaintiffs alleged that the schools discriminate against the hearing impaired by failing to caption

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online content they make available to the general public, including massive open online courses (MOOCs). As they do in many of these cases, the DOJ has filed a statement of interest in support of the NAD's claims, arguing that the ADA applies to websites. The cases are ongoing.

Most recently, a law firm in Pittsburgh recently sent out over 25 demand letters to realty and home-building companies threatening legal action over the inaccessibility of their websites, alleging inaccessible sites violate the civil rights of individuals with disabilities. The firm claims to have over 100 clients in 40 states who are plaintiffs or represented by demand letters.

Accessibility According to the DOJ

The DOJ announced in 2010 that it was considering amending its regulations implementing Titles II and III of the ADA to require website accessibility and sought public comment. Title II, applicable to government sites, was expected in early 2016 and was to be used as the model for Title III regulations. Disappointingly, the DOJ withdrew its Notice of Proposed Rulemaking on April 28, 2016, and issued a Supplemental Advance Notice of Proposed Rulemaking, soliciting additional comments. Title III, applicable to places of public accommodation, is expected in 2018.

Industry groups have been clamoring for the rules to be promulgated. For example, in April 2016, The National Association of REALTORS (NAR) sent a letter to the Department of Justice requesting that they finalize Title III rules. The letter cites the ad hoc rulemaking via Statements of Interest and enforcement actions as creating confusion for its membership as to the requirements for website accessibility.

In the meantime, the DOJ has filed statements of interest in numerous cases filed against website owners and entered a multitude of consent decrees against entities, including Peapod, H&R Block, and (somewhat ironically) the National Museum of Crime and Punishment. In those decrees, the DOJ uses the Web Content Accessibility Guidelines (WCAG) 2.0 Level AA Success Criteria developed by the World Wide Consortium as their guidance in proceedings. It is important to note that some DOJ settlements have given websites a mere 120 days to comply with those guidelines.

WCAG 2.0 Guidelines

Developed by the World Wide Web Consortium (W3C), whose members include Microsoft Corporation, Facebook, and Google, Inc., among others, the WCAG 2.0 guidelines provide a detailed standard for web content accessibility. Although highly technical and clearly written for web developers, counsel for entities with websites should be familiar with the guidelines and advise clients on their use. There are 12 guidelines organized into four principles: perceivable, operable, understandable, and robust. Each guideline has testable success criteria at three levels: A, AA, and AAA. The DOJ favors the AA Success Criteria. Following the guidelines will make websites more accessible to persons with disabilities who use assistive technologies such as speech-to-text software, scanning and switches, etc.

Perceivable

The user should be able to perceive the information and user interface components using their available senses. For example, developers should provide text alternatives for nontext content. This can mean providing captions for audio content and adding in audio descriptions of visual details in video. Sign language can also be added for audio content, including signed descriptions of sounds that are not speech. Developers should create content that can be presented in different ways, including by assistive technologies, without losing meaning.

Websites should have a site map with headings, lists, and tables that are marked-up properly. Designers can make it easier to see and hear content by separating background from foreground using sufficient contrasting colors and not relying on color as the only way of conveying information or identifying content. Text should be resizable up to 200 percent without losing information, and images of text should be resizable, replaced with actual text (i.e., using actual text instead of pictures of words), or avoided where possible.

Operable

The features of the website should be operable by either assistive technology or adaptive strategies. This means making all functionality available from the user's keyboard so that anything the mouse can do, the keyboard can also do. This allows programs such as speech-to-text to simulate keyboard functions. In addition, keyboard functions, such as tabbing across options, should not get lost in the content. It should be clear where the user is on the page. If there is scrolling content, the user should be able to pause or stop the text, and if there is a timed session and it times out, the user should be able to log back in within a short period time without losing data or losing their place on the page.

To help avoid seizure in some epileptic users, avoid unnecessary flashing lights. Seizures triggered by flashing lights occur when the frequency flashing is between five and 30 flashes per second. Other factors can include brightness of the lights and contrast with background lighting. Avoid video content that may cause seizures.

Understandable

Users should not only be able to understand the content, but also how to navigate the pages and the website as a whole. Developers should make the text readable and understandable. This means identifying within the code the primary language of a web page, such as English, Arabic, or Chinese. Use clear language and provide definitions of unusual words, phrases, or abbreviations. Further, content should appear and operate in predictable ways. Modes of navigating the pages and sites that repeat on multiple pages should be in the same place on each page. Features that appear on multiple pages should be labeled identically on each page.

Lastly, webpages should be designed to assist users in avoiding and correcting mistakes. Instructions and error messages should be clear and unambiguous. Error messages should also contain suggestions

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for correcting the error. Users should be given the opportunity to review and correct submissions, or even reverse submissions.

Robust

Content must be robust enough that it can be accessible by a wide variety of assistive technologies and adaptive strategies, even as assistive technologies improve. To do this, developers should maximize compatibility with current and future user tools by ensuring that page mark-ups can be reliably interpreted by assistive technologies and by providing name, role, and value for nonstandard page features.

Final Thoughts

Building accessibility into a website from the beginning is less costly than trying to rearchitect the site after litigation ensues. By counseling clients from the beginning to use the WCAG 2.0 guidelines, clients can avoid having to go back and correct inaccessible pages and features post-litigation or post-rulemaking. Although the DOJ has not issued guidelines on accessibility, and will not for some time, it has made it clear through consent agreements and statements of interest that the ADA applies to websites and that they will enforce it.

As outlined above, advocacy groups have become more active in filing lawsuits, and business clients are losing customers and users if inaccessible websites shut out disabled potential customers. As more of our lives go online and Internet life becomes ubiquitous, it is unlikely that the ADA will continue to be interpreted in some jurisdictions to require a physical place to apply. The mandate is therefore clear: whether connected to a physical place or not, websites must be ADA accessible, and the best way thus far to accomplish that is to follow the WCAG 2.0 guidelines.

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BUSINESS LAW TODAY

What Non-Californians Need to Know about California Taxes

By Robert W. Wood

You might think first and foremost about the Internal Revenue Service when you think about taxes. If you live or do business in California, however, state taxes are a big piece of what you pay, and surprisingly, you might have California tax exposure even if you never set foot in the Golden State.

In fact, as many individuals and companies across the country and the world are aware, California aggressively draws people into its tax net. California has high individual (13.3 percent) and business (8.84 percent) tax rates. When you add the state's notoriously aggressive enforcement and collection activities, California does well with both residents and nonresidents on any California-source income.

California can tax you on all of your California-source income even if you are not a resident of the state. If California finds that you are a resident, it can tax you on *all* of your income regardless of source. A nonresident's income from California sources includes income from a business, trade, or profession carried on in California. If a nonresident's business, trade, or profession is carried on both within and outside California, the income must be allocated across multiple states. Not surprisingly, California often finds a way to steer more dollars toward the state. For that reason, some multistate businesses try to compartmentalize their California and non-California operations.

California offices, especially a headquarters office, can be especially worrisome. Out-of-state businesses that want to move into California should obtain some tax advice first. A California office or headquarters may make perfect sense, but one does not want to expose non-California income, assets, and personnel to California taxes unnecessarily.

The sale of real estate is another common point of confusion. As one might expect, when a California resident sells California real estate, the gain is taxable by California. What if a nonresident sells California real estate? This is considered California-sourced, so the gain is taxable by the state of California even if sold by a nonresident.

Estate planning and probate matters can also trigger tax concerns. California assets often will mean California tax returns and filings, which should be considered carefully to minimize the reach of the state.

Navigating California's tax system can also be complex. For example, rather than adopt federal tax law wholesale, California's legislators pick and choose. Administratively, the state's tax authorities adopt some rules, but not others. California tax law has many nuances that do not track federal tax law. Even California's tax agencies and its tax dispute-resolution system are unusual, and when you add California's unique tax statute of limitations, it can be downright scary. There are a few key rules about California's long tax audit period that everyone should know.

How Long Can They Audit?

The basic federal income tax statute of limitations is three years in most cases. One must note that, in an increasing number of cases, the IRS audit for up to six years, not three. Barring those kinds of exceptions, however, the general federal rule for how long the IRS has to audit is three years. That means that, once you file a federal income tax return, the IRS usually has three years to audit. This is measured from your actual filing date, provided that you file on time or file late. If you file early (before the April 15 deadline), the three years is measured from the due date.

The California Franchise Tax Board (FTB) administers California's income tax. The FTB gets an extra year after the IRS audit period expires, so the FTB generally has four years, not three. That can invite some interesting planning. Assume that you are involved in an IRS audit, but the IRS has not yet issued a Notice of Deficiency (also called a 90-day letter, which must come via certified

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mail). You might want to drag your feet or otherwise hope that your federal tax dispute will put you outside of California's reach. With a little delay, maybe you can prevent the issuance of an IRS Notice of Deficiency until after California's four-year statute has run. Will that protect you from California's follow-along "me too" request for money? Not really. Several things can give the FTB an unlimited amount of time to audit.

First, like the IRS, California gets an unlimited time to come after you if you never file an income tax return. The same goes for false or fraudulent returns. Keep in mind that you might not file a California tax return because you thought you were not required to do so. For example, you might think that you are no longer a resident; California might say you are. Alternatively, you might think that you do not have any California-source income, so you do not file a return. However, if you sold a piece of California real estate, received a distribution from a California partnership or LLC, etc., the state might think differently. Not filing a California return—even if your belief was reasonable—means that the California statute of limitations to audit never runs. Ever.

There are other dangers, too. In certain other less intuitive cases, California also gets unlimited time to audit. Suppose that an IRS audit changes your tax liability, as occurs frequently. Perhaps you lose your IRS case, or you just agree with the IRS during an audit that you owe a few more dollars. You might simply sign and send back an assessment to the IRS. In that event, you are *obligated* to notify the California FTB within six months. If you fail to notify the FTB of the IRS change to your tax liability, the California statute of limitations *never* runs. That means you might get a billing 10 or more years later. Yes, it happens. California's FTB often comes along more promptly after the IRS to ask for its piece of a deficiency.

Whether California gets a notice of the adjustment from the IRS or not, California taxpayers have an obligation to notify the FTB and to pay up under section 18622(a) of the Cal. Rev. & Tax. Code. Under section 19060, failing to notify the state means that the California statute of limitations never runs. You can wait for the IRS and California to exchange information, which usually means the FTB will send you a notice. That occurs often within one year or so of the conclusion of your IRS case, but it *can* happen 10 or 20 years later, and if it does, you probably just have to pay it, including interest. As a result, if you settle up with the IRS, you should settle up with the FTB as well.

Other Statute Extensions

This coattails concept in California tax law also applies to amended tax returns. If you amend your federal tax return, California law *requires* you to amend your California tax return within six months if the change increases the amount of tax due. If you do not, the California statute of limitations *never* expires.

With all of these rules, should you ever *voluntarily* give the FTB more time to audit you? Surprisingly, yes. Again, the basic rule is that the FTB must examine your tax return within four years after you file it. Like the IRS, however, the FTB sometimes will contact you to ask for more time. The FTB may send you a form, asking you to sign it to extend the period of limitations. This part of California's system operates pretty much like its IRS counterpart. Some taxpayers just say "no," comparing the extension request to giving a thief more time to burglarize their home, but saying "no" usually triggers an assessment, generally based on quite adverse assumptions against you. Thus, you should usually agree to the extension. You might be able to limit the scope of the extension to certain tax issues or to limit the added time, but most tax advisers will tell you that agreeing to give the IRS or FTB more time usually is the wiser choice.

California Audits That Precede the IRS

Given California's aggressive tax enforcement, the FTB often audits even when the IRS is not involved. What happens if your audit route works in reverse order? Suppose, as commonly occurs, you have a California tax audit *first*, and by the time it is resolved, the federal statute of limitations has run?

Happily, with the IRS statute of limitations closed, you probably dodged a bullet. Unlike California, the IRS does not have a "me too" extension of the time to audit. Thus, even if California notifies the IRS (and they do exchange information), it may be too late for the IRS.

California tax advisers frequently count on this result. Because the California statute is four years and not three, it is possible that California may initiate its audit after the federal statute is already closed. More likely, if the California audit has been initiated one to two years after a return filing, there may be only one to two years left on the three-year federal statute.

Even without trying to cause a delay, the California audit and ensuing administrative appeals may not be resolved until after the three-year federal statute has run. If delays are desirable, they can often be accomplished with little effort. The federal statute often will have run when the California adjustment or deficiency is finalized. California may still notify the IRS of the adjustment, but at that point it may be too late for the IRS to say "me too."

California Tax Controversies

Most individuals and businesses have some sense about contesting IRS tax bills. If you have an IRS dispute, you can fight it administratively with the auditor and the IRS Appeals Office. If necessary, you can then go to U.S. Tax Court, where you can contest the tax before paying. Alternatively, you could proceed to the U.S. Court of Federal Claims or the U.S. District Court (if you are willing to pay the tax first), but if you try to apply much of this learning to California, you are in for a surprise. Many states have a state tax court, but California does not. Instead, it has a State Board of Equalization (SBE).

The SBE is a five-member administrative body—the only elected tax commission in the United States—that functions much like a court. If you are unable to resolve an income or franchise tax dispute with the FTB (which frequently occurs), you can appeal it to the SBE. The SBE will hear your side of the case and the counterarguments from

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the FTB. The SBE will rule on the law, but it also has equitable powers.

In fact, it is not uncommon for the SBE to bend the rules if they are persuaded that the taxpayer is honest, forthright, and sympathetic, although one cannot count on that. In many ways, the deck is stacked against you as a California taxpayer, so every little bit helps. Notably, the SBE does not just hear income tax appeals; it also hears sales and use tax cases and even property tax appeals. If you are unable to resolve an income tax case, property taxes, sales or use taxes, or even an excise tax matter, you can appeal it to the SBE. The SBE is where the action is in California. However, even the nomenclature can be puzzling.

Confusingly, in addition to the five-member SBE (the ruling body), there is also a large agency called the SBE that administers sales and use taxes. When merchants talk of undergoing a state board of equalization audit, they mean a sales tax audit by the agency. If you cannot resolve your sales or use tax dispute administratively with the SBE (the agency), you can appeal to the SBE (the five-member body).

Unlike state sales and use taxes, California's property taxes are administered by local county tax collectors throughout California. If you cannot resolve your property tax dispute with the local authorities, though, that tax dispute can also eventually end up at the SBE. When it comes to California taxes, you might say that all roads lead to the SBE.

Make no mistake, California's five-member SBE has a very tough job. They are elected, and they have a constituency. They try to resolve and administer California's vast and complex tax laws, and most of the board members are not tax professionals. They are also not judges, so it is okay to talk to them *ex parte*—to lobby them, you might say.

Individual Polling

It is common for California tax professionals to seek out the individual members of the SBE in advance of a hearing. You can give them a private advance screening (so to speak) of what your client's case is about and why you think your client should prevail. In a fashion similar to lobbyists who are trying to count on legislator votes on a bill facing an upcoming vote, you can try to persuade the individual SBE members to vote your way.

You may or may not be able to garner a commitment that your client's tax position is meritorious, but information, as they say, is power. If the SBE member is going to vote against you, you are at least better off knowing that in advance. You might find that the particular tax case in question is going to go down political party lines. For example, perhaps Republicans will vote for the taxpayer, and Democrats will vote for the state. You might get clear signals or outright statements that an individual SBE member cannot—or will not—vote for your client. Sometimes a "no" vote in this circumstance can have its own kind of empowerment. Indeed, where this happens, one of the most unique features of California's tax system kicks in: money.

You may donate to that SBE member who will vote against you. This may sound counterintuitive, but the idea is that both you and the SBE member must then disclose that contribution. Any contribution of $250 or more must be disclosed. Your contribution will *disqualify* that SBE member from considering your case. The only exception is if the SBE member returns the contribution within 30 days from the time he or she knows, or has reason to know, of the contribution. Often, though, a contribution will not be returned.

With a five-member board, if you identify two members who will vote against your client and make contributions to them, they will likely be disqualified. Your board is now three members. If you can garner two positive votes out of the three remaining, you have won. Non-Californians may find this kind of playing field strange or even untoward. It is certainly different, and not for the untutored, but until they change the rules, that is our system.

One-Way Appeal

Another feature of California tax law that can be quite important is what happens *after* an SBE dispute. The SBE is a unique forum. Perhaps particularly because of its powers to do equity as well as apply the statutes, it can sometimes offer unexpectedly good results. On the other hand, if the taxpayer is a large company that might be seen as skirting California's tax system and taking its resources, you may feel decidedly discriminated against by the SBE. Whatever the case, the SBE is an important venue for tax problem resolution in California and should not be taken lightly.

This is true for what it is, and for what can happen to a California tax case *after* the SBE. If you win before the SBE, that decision is binding on the FTB. The FTB can submit a petition for rehearing within 30 days of the date of he decision. However, the FTB cannot appeal or go on to another body or court. That can be frustrating to the FTB's tax lawyers who may feel they are correct on the law but may nevertheless lose. If they lose, they cannot appeal. In contrast, if the taxpayer loses at the SBE, the taxpayer can bring suit in California Superior Court, the primary trial level courts in California, for a *de novo* trial of the tax dispute.

This one-way appeal right, something only the taxpayer has, is a nice taxpayer protection. If you do sue in Superior Court, you will have a regular judge, not a tax specialist. Most federal tax disputes are heard in U.S. Tax Court by a judge with special tax training. Superior Court also offers you the chance for a jury trial. If you are a California taxpayer or represent one, however, you want to win before the SBE. There have been proposals to allow the FTB to also appeal adverse SBE decisions against it, but so far only the taxpayer can go on to Superior Court.

As these rules make clear, be careful when dealing with California taxes, and if you are a nonresident with only passing occasion to deal with California taxes, try to keep it that way!

Robert W. Wood is a tax lawyer with www.WoodLLP.com and the author of numerous tax books including Taxation of Damage Awards & Settlement Payments (www.TaxInstitute.com). This discussion is not intended as legal advice.

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BUSINESS LAW TODAY

Threats to the SEC's Independence

By Roberta S. Karmel

At the November Business Law Section meeting, former SEC Commissioner Roberta Karmel was the keynote at the Securities Committee Luncheon, and delivered the following remarks about the need to preserve the independence of the SEC.

* * *

The Securities and Exchange Commission (SEC) was created as an independent federal regulatory agency. Its commissioners over the years have been chosen for their expertise and have come from various backgrounds and geographical regions. Throughout the SEC's long history it has enjoyed great respect from the securities industry, the bar and the public. But the period of the Obama presidency has given rise to a poisonous partisanship that threatens the SEC's independence and effectiveness. If this continues, the end result will be a lack of respect for the SEC and its extremely important role in policing and overseeing the public securities markets.

The attacks on the SEC's independence have come from the right, the left, and the D.C. Circuit Court. A substantial segment of the Republican Party sees as its mission the destruction of government agencies, but it has succeeded only in sowing the seeds of disillusion with America and democracy, not only in our country but also abroad. Yet, Democrats have also participated in attacks on the SEC's independence.

Independence and nonpartisanship were both values in the creation of the SEC and other federal independent agencies, but a greater value was expertise. In today's complicated, technologically advanced world, expertise is probably needed more than ever in regulation, but populists on the right and left have debunked expertise and shown a lack of respect for government leaders.

In the current highly divisive and partisan world, nominated members of the SEC other than the chair have been paired as Democratic and Republican commissioners—many of whom have a background from the Congressional committees that have oversight over the SEC. President Obama's first choice of a Democratic commissioner to replace Commissioner Aguilar was torpedoed by Senator Elizabeth Warren because he came from a private law firm. Many stellar SEC commissioners had such a background in the past, and because they were experts and they left their clients at the door, they were able to make significant contributions to the development of securities regulation. These commissioners include: Ray Garrett, Frank Wheat, Richard Smith, and Al Sommer. Recent Republican commissioners, including Kathleen Casey, and the nominee Hester Peirce, have worked for Senator Richard Shelby.

When Senator William Proxmire was head of the Senate Banking Committee, he preferred the appointment of persons with prior experience on the SEC staff. Although I was then in private practice in New York, and that experience was considered one of my strengths by the Carter White House, I was confirmed without difficulty by the Senate Banking Committee headed by Senator Proxmire because I had begun my career on the staff of the SEC New York Regional Office. Two of the other commissioners then were Irving Pollack and Philip Loomis, former SEC staffers and a third, John Evans, had been on the Senate Banking Committee staff. Only the chairman, Harold Williams, a tax lawyer, had experience in the business world. That background did not make him a tool of the business community but an adherent of corporate governance reform.

In my opinion, while a background in government is useful, an agency like the SEC needs some commissioners who have had real world experience in business or the private practice of securities law. Nevertheless, we do not need SEC commissioners

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who do not believe in the mission of the SEC or who would like to take a hacksaw to all government regulation. I am very afraid that the Trump administration and the Republican Congress will try to destroy the SEC, or in any event, the SEC's independence.

Today, neither the SEC chair nor the president seems to enjoy the freedom to choose non-partisan candidates who will be confirmed by the Senate. Qualifications are based on ideological correctness rather than expertise. This has led to very contentious and partisan decision making with many 3–2 decisions, or even worse, 2–1 votes, on important issues. Moreover, the selection of commissioners in this manner results in strong dissents designed to enable affected constituencies to appeal rulemaking to the United States Court of Appeals for the District of Columbia Circuit and prevail by upending new regulations. (See, e.g., Nat'l Ass'n of Mfrs. v. SEC, 748 F.3d 359, 363-65, 373 (D.C. Cir. 2014); Am. Petroleum Inst. v. SEC, 953 F. Supp. 2d 5, 8 (D.D.C. 2013). I am not opposed to dissents; I authored a few when I was a commissioner, but these were based on principle, not party. Partisanship has been a historical hallmark of some agencies, like the National Labor Relations Board, where labor and management commissioners are often at odds. It was not traditionally the case at the SEC where the agency's mission is to police the securities markets and protect investors, and where influence by outside political forces once was rare.

In my opinion, partisanship has undermined the SEC's mission and credibility and made it very difficult for the SEC to complete rulemaking mandated by statute. It took five years for the SEC to complete the bulk of mandated rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), in part because Republicans in the Congress and at the SEC objected to many statutory provisions. In the meantime, Congress passed the JOBS Act, which mandated new deregulatory rules, and again the SEC was slow to pass rules implementing this law because Democrats found it objectionable. When the agency operated in a collegial manner, I believe it was more effective and respected and was able to pass rules without rancor.

In addition, the courts have been politicized. Much of the delay in SEC rulemaking has come from D.C. Circuit Court decisions vacating SEC rulemaking on cost-benefit grounds or other related rationales. Although I think that the SEC should be mindful of the economic effect of its rules on regulated businesses, the inordinately lengthy rulemaking proposals and adopting releases that the SEC has been forced to produce, do not serve the orderly development of the law or the public interest. Furthermore, those politicians who want to repeal regulations may be surprised to discover this process is lengthy and cumbersome just like rulemaking.

Representative Jeb Hensarling's Financial Choice Act, a likely start for re-regulation of financial services, would severely cripple the SEC. Not only would rulemaking be subject to even more stringent cost-benefit and other constraints than is now the case, but the Enforcement Division would be under the thumb of Congress. Also, the Enforcement Division would have to verify that its actions are within SEC authority and consistent with the Administrative Procedures Act. The economic consequences of a civil penalty on an issuer would have to be considered. This idea of some kind of a cost-benefit analysis for enforcement cases seems ludicrous.

Dodd-Frank had many laudable purposes and most of its provisions were a serious and worthwhile response to the problems that led to the financial meltdown of 2008. But some of its provisions forced the SEC to wade into political quagmires that had little or nothing to do with investor protection. One example is Section 1502 of the Dodd-Frank Act, which mandated that the SEC require registered and reporting companies under the Securities Exchange Act of 1934 to disclose whether conflict minerals from the Democratic Republic of the Congo were necessary to the functionality or production of any of a company's manufactured goods. The rationale for this provision was that armed groups were financing the DRC's brutal civil war by exploiting and trading conflict minerals.

Although the D.C. Circuit Court rejected an attack based on an inadequate cost-benefit analysis, of the SEC's rule passed pursuant to Section 1502, the court did so holding that the SEC had no choice under the statute but to promulgate a disclosure rule. Yet, it observed that "the rule's benefits would occur half-a-world away in the midst of an opaque conflict about which little reliable information exists, and a concern about a subject about which the Commission has no particular expertise." (Nat'l Ass'n of Mfrs., 748 F.3d at 369.) The Republicans have campaigned to repeal Dodd-Frank. That would be a terrible mistake, but it certainly could benefit from a bipartisan corrections bill. The Financial Choice Act, referred to already, is not such a bill.

An even more trenchant example of partisan political pressure being exerted on the SEC is conflicting Republican and Democratic reactions to the petition for rulemaking on public company disclosure of political contributions. After the U.S. Supreme Court decided the *Citizens United* case, the Committee on Disclosure of Political Spending, co-chaired by Professor Lucian Bebchuk of Harvard Law School and Robert J. Jackson of Columbia Law School, sent a petition to the SEC to start a rulemaking proceeding to require disclosure of corporate political contributions (Bebchuck-Jackson Petition). (Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010). See also McCutcheon v. Fed. Election Comm'n, 134 S. Ct. 1434 (2014)). In addition, these co-chairs authored a law review article arguing in favor of SEC rulemaking. Lucian A. Bebchuck & Robert J. Jackson, Shining Light on Corporate Political Spending, 101 GEO. L. J. 923, 967 (2013). This petition and its favorable response were prompted in part by a statement in *Citizens United* by Justice Kennedy. He noted that "with the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters."

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There are two different issues involved with regard to disclosure of political spending—campaign contributions and lobbying activities. The SEC has received millions of comments supporting the Bebchuk-Jackson petition from a diverse array of constituents—public interest groups, federal law makers, trade unions, and major investor firms. Yet, there are serious objections to the petition also. Political contribution disclosures are already required to be made to the Federal Election Commission and many highly significant contributions are made by individuals, not public corporations. Lobbying is customarily by trade associations rather than individual corporations. In any event, the issue is essentially political. Some commenters therefore believe that the SEC should have no role regulating campaign finance in the first place. My own view is that *Citizens United* was a pernicious case, but the SEC should not be required to enforce all worthwhile federal regulations by way of its disclosure rules.

In 2013 and 2014, there were been bills introduced in Congress to compel the SEC to mandate political contribution disclosures, and bills to prevent the SEC from mandating such disclosure. A provision written into the policy riders of the 2016 Omnibus Appropriations bill, passed on December 18, 2015, explicitly prohibits the SEC from using any funds to finalize political contribution disclosure rules during fiscal year 2016. A group of Congressional leaders, led by New York Sen. Charles Schumer, was quick to inform the SEC via an open letter that the language of the bill does not prohibit the Commission from preparing, researching, or investigating potential rules, and urged the SEC to remain committed to the issue.

At least one NGO sought to force the SEC to enact a political contribution disclosure role when the SEC failed to act on its petition for rulemaking. The NGO then sued to compel the SEC to act. On January 4, 2016, Judge Rosemary Collyer dismissed the suit, writing that "Since the SEC has not denied the petition and . . . [the NGO] has not asserted that the SEC failed to act in response to a clear legal duty, it follows that he failed to state a valid APA claim upon which relief can be granted." (Silberstein v. SEC, 2016 WL 29253 (D.D.C. Jan. 4, 2016)).The decision effectively holds that the SEC is not obligated to respond to petitions by NGOs and private citizens seeking to set the SEC's rulemaking agenda. As pointed out by former SEC Chair Arthur Levitt in a *Wall Street Journal* Op Ed, the SEC's agenda should not be decided by rulemaking petitions.

The furor over the Bebchuk-Jackson political spending petition did not subside after these events. The nominations of two SEC commissioners to fill vacancies has been held up in the Senate by Democrats because they did not testify during their confirmation hearings that they would push forward on a rulemaking advancing the petition. Even worse, Senator Elizabeth Warren, suggested that Chair Mary Jo White be fired as SEC chair by President Obama and demoted to a commissioner because Chair White has refused to engage in rulemaking to compel public companies to disclose their political contributions. Missing from this pique on the part of Senator Warren is the fact that the SEC is prohibited by statute from doing so, a piece of legislation that she voted for.

Senator Warren also criticized Chair White for embarking on a project to streamline SEC disclosure policy and improve public company reporting. In the face of unprecedented and contradictory assignments from Congress for new regulatory and de-regulatory rulemaking, in the Dodd-Frank and JOBS Acts, disclosure reform is an extremely worthwhile project aimed at the agency's core mission of investor protection. This project was prompted by mandates from Congress in the JOBS Act and the FAST Act, the SEC has been implementing this reform with extensive and thoughtful rulemaking proposals. I hope this project will continue to move forward in the next administration.

The suggestion that the chair of the SEC be fired seems to be an election year gambit. Eight years ago, Senator John McCain asserted that if he were president he would fire the then chair of the SEC for failing to prevent the 2008 financial crisis. The SEC is supposed to be a collegial agency of nonpartisan experts. Instead it has become an agency riven by partisanship due to politicians trying to score points and gain publicity.

Chair Mary Jo White has been criticized by the right and the left which is a tribute to the great job she has done and how much she has accomplished. We owe her a debt of gratitude in serving as SEC chair during such difficult and contentious years.

One of the many threads in the Watergate scandal was an effort by the Nixon White House to interfere with an enforcement case by the SEC against Robert Vesco who had given money to the Nixon campaign. By contrast, when I was a commissioner, the SEC and the comptroller of the currency brought an action against Bert Lance, President Carter's budget director, without any pressure to defer this case coming from the White House. It is because of cases like this that the independence of the SEC is essential for the agency to accomplish its mission.

The president's power to remove agency members from office only for "cause" has long been considered a key feature of agency independence by academics Yet, I believe that two other earmarks of independence—agency control of its own litigation and independent funding—are more important as a practical matter. If the SEC did not have the ability to sue anyone the agency believes has violated the securities laws—including high-level political appointees and members of Congress—it would not be as independent as the SEC is today. The effort by the Nixon administration to quash the SEC's case against Robert Vesco, which I already referred to, led to the resignation of an SEC chair, and was the first serious scandal in which the SEC was ever embroiled. When I was an SEC commissioner, this event resulted in a preoccupation with affirming agency independence from the president, but not from the Congress. Yet, today, it is members of Congress—both Republicans and Democrats—who are threatening the SEC's independence. Agencies are often criticized for

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having been captured by the industries they regulate, but agency capture occurs by way of congressional pressure.

In my opinion, independent funding is a key to such agency independence as enjoyed by the Federal Reserve Board. Although the SEC takes more money into the U.S. Treasury than its budget, from registration fees and fines, the SEC budget is subject to annual appropriations by the Congress. Serious efforts to insulate the SEC from partisan and Wall Street interference by giving the agency independent funding authority floundered in Dodd-Frank, due to Democratic opposition. I am very worried that in a Trump administration, the SEC will be starved for funds and unable to perform effectively. I am also worried that the Enforcement Division will become subject to congressional political pressures and be unable to function with integrity.

I believe that everyone in this room, whether Republicans or Democrats cares about the work and reputation of the SEC because the SEC's work is our work. We need to push back against the destructive partisanship that is fueling so much fury against government and government appointees and employees. It is time to give our government and agencies like the SEC some serious respect and allow them to do the work they were created to accomplish. Yet some of the ideas now being floated would not reform the securities laws or the SEC, but eviscerate them.

I am going to conclude this talk on a personal note. I initially drafted this plea for SEC independence when I thought Hillary Clinton would become president but there would be a Republican Congress and four more years of gridlock. Instead I believe we are going to witness something worse—an administration that wants to build walls of ignorance and bigotry and retreat into isolationism in order to return to the 1950s. But the 1950s were not only a time of lucrative manufacturing jobs; they were also the years of de facto segregation, McCarthyism and anti-intellectualism. I fear the Trump administration will deregulate the capital markets so that they become the province of fraudsters and fail to raise and allocate capital properly.

I have been an internationalist since I was a child and corresponded with pen pals all over the world. I have enjoyed the practice and teaching of securities regulation because it has been a window on to the global capital markets and the world economy. Now I am pessimistic about the continued health of the global capital markets and an international regulatory system to support those markets and world trade.

You and I are part of the elite that is being rejected by Brexit and the followers of Donald Trump. Perhaps we have taken too large a share of the wealth generated by an open economy and open borders. But lower taxes for the rich and closing off immigration will not solve the problems of the people left behind in the American Midwest and elsewhere. Gutting the securities laws will not preserve their meager savings or create new jobs. As lawyers, we need to uphold the rule of law and the administration of justice. As securities lawyers, we need to be watchful of threats to the SEC's independence and very existence.

Professor Karmel is Centennial Professor of Law at Brooklyn Law School, and is an acknowledged expert in international and domestic securities regulation. She is a former Commissioner of the Securities and Exchange Commission, a former Public Director of the New York Stock Exchange, and was in private practice for 30 years. She was also a Fulbright Scholar studying the harmonization of the securities laws in the European Union. She is the author of Life at the Center: Reflections on Fifty Years of Securities Regulation and Regulation by Prosecution: The Securities and Exchange Commission Versus Corporate America, and has widely published articles on securities regulation and international securities law in law reviews and journals. She also authors a bi-monthly column, "Securities Regulation," that appears in the New York Law Journal. Professor Karmel's professional activities and affiliations are numerous. She is the Chair Emerita of the Board of Trustees of the Practising Law Institute, a member of the American Law Institute, and a Fellow of the American Bar Foundation. She also served on the ABA's Presidential Task Force on Financial Markets Regulatory Reform. She previously served as a director of the New York Chapter of the National Association of Corporate Directors and was the Vice-Chair of the International Coordinating Committee of the ABA Business Law Section.

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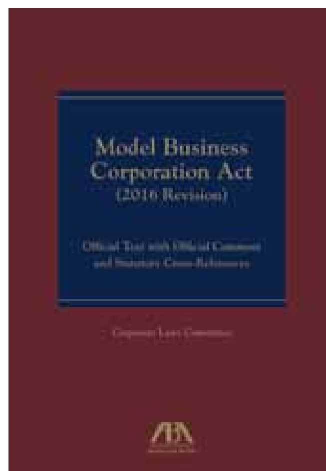
BUSINESS LAW TODAY

2016 Revision to Model Business Corporation Act Makes Its Debut

Business Law Section's Corporate Laws Committee will publish this month the first complete revision to the *Model Business Corporation Act (2016 Revision)* since 1984. Dozens of members from Corporate Laws have worked on this seminal book, and it is considered one of the most respected books published by the ABA.

The Model Act is a free-standing business corporation statute that can be enacted in its entirety by a state legislature. This Model Act is the basis for the business corporation statute in 32 states and the District of Columbia and is the source for many provisions in the general corporation statutes of other states.



Beginning in 2010, the Corporate Laws Committee has undertaken a thorough review and revision of the Model Act and its Official Comment. This effort has resulted in the adoption and publication of the *Model Business Corporation Act (2016 Revision)*. The 2016 Revision is based on the 1984 version and incorporates the amendments to the Model Act published in supplements regularly thereafter, with changes to both the Act and its Official Comment. Also included are notes on adoption and revised transitional provisions that are intended to facilitate legislative consideration in adopting the new version of the Model Act.

"The Committee intends and hopes that the publication of the 2016 Revision will encourage state legislatures—in states that have already adopted all or a substantial part of the Model Act and in other states as well—to consider adopting the Model Act in full and thereby bringing their corporate statutes into line with recent developments in corporate law," said David Martin, chair of Corporate Laws.

The Corporate Laws Committee's mission is to adopt amendments to and provide expert commentary on the Model Act.

For more information on the book, click here.

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BUSINESS LAW TODAY

Keeping Current:

HR Professionals Beware: Antitrust Violations in the Employment Arena May Subject Employers and their HR Personnel to Criminal Prosecution

By Lauren Norris Donahue and Gina A. Jenero

The Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC) (collectively, the "Agencies") recently announced a policy shift in their enforcement priorities related to agreements among competing employers. Specifically, the Agencies expressed the DOJ's intent to criminally prosecute employers and individuals who enter into naked wage-fixing or no-poaching agreements with other employers. (Department of Justice Antitrust Division & Federal Trade Commission, Antitrust Guidance for Human Resource Professionals (Oct. 20, 2016)). The DOJ stressed that "an agreement among competing employers to limit or fix the terms of employment for potential hires may violate the antitrust laws if the agreement constrains individual firm decision-making with regard to wages, salaries, benefits; terms of employment; or even job opportunities." While such conduct has always carried potential criminal liability (both for corporations and individuals) under the antitrust laws, the Agencies have typically dealt with such violations through civil proceedings. The Agencies, however, through issuance of their *Antitrust Guidance for Human Resource Professionals*, have sent an important warning to employers and HR professionals that such conduct now may be investigated by a grand jury and prosecuted criminally.

As a result of this announcement, all companies that compete for employees—including nonprofits, universities and other entities that typically view themselves as having little exposure to violations of antitrust law—should review their compliance programs to ensure that proper policies and procedures are in place and that management and human resource professionals are appropriately trained to avoid inappropriate discussions or agreements with other companies seeking to hire the same employees.

The Effect of the Antitrust Laws on the Employment Market

The purpose of the antitrust laws is to promote a competitive marketplace. A competitive marketplace among employers "helps actual and potential employees through higher wages, better benefits, or other terms of employment." Firms that compete to hire or retain employees are considered competitors in the employment marketplace, even if those firms do not compete in the same product or service market. Employers may violate the antitrust laws when they agree not to compete for employees. Some examples of illegal conduct provided by the Agencies include:

- An agreement "with an individual at another company about employee salary or other terms of compensation, either at a specific level or within a range (so-called wage-fixing agreements);"
- An agreement "with an individual at another company to refuse to solicit or hire that other company's employees (so-called 'no poaching' agreements)."

An agreement need not be formal or in writing to violate the antitrust laws—any kind of informal or "gentlemen's agreement," or other tacit or implied understanding concerning employee compensation or recruiting is similarly prohibited. In this regard, unlawful arrangements may be inferred from circumstantial evidence. For example, exchanges of competitively sensitive information related to terms of employment or recruitment strategies among competitors can be used to infer an agreement.

The Agencies have indicated their intent to criminally prosecute naked wage-fixing or no-poaching agreements—that is, agreements separate from or not reasonably necessary to achieve a legitimate business purpose between the employers. Such agreements will be considered "per se" illegal, meaning that the agreement need not result in actual adverse competitive effects to be deemed illegal.

Violations of the Antitrust Laws Can Result in Severe Penalties

Violations of the antitrust laws can result in serious consequences for employers and

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any individual directly or indirectly involved in an illegal agreement. Such consequences include:

- Criminal prosecution under felony charges for both the corporation and culpable individuals (i.e., internal management, HR personnel, or third parties). Corporations found guilty of criminal violations of the antitrust laws face significant fines (up to $100 million), while individuals may be subject to imprisonment (up to 10 years) and significant fines (up to $1 million).
- Civil enforcement actions by the Agencies that can result in broad-ranging injunctions governing future conduct.
- Private, civil actions by employees or third parties injured by the violation. Such lawsuits can be extremely costly to defend, both in terms of monetary costs and lost time of officers and employees, and can result in treble damages (three times the losses suffered by the complaining party).

Avoiding Liability

There are a few important steps employers can take to avoid liability under the antitrust laws.

First, refrain from engaging in agreements—or potentially problematic communications—with competitors regarding wages, salaries, benefits, terms of employment, or recruitment strategies that do not serve a legitimate purpose. Such agreements among employers are considered per se illegal under the antitrust laws. In the past, simple agreements to refrain from cold calling a certain competitor's employees have subjected companies to civil liability, but could now result in criminal liability. If you believe such an agreement serves a legitimate purpose (such as a joint venture), antitrust counsel should be consulted to ensure the defensibility of the agreement.

Second, abstain from sharing competitively sensitive information regarding wages, salaries, benefits, terms of employment, or recruitment strategies with competitors. Competitors that share this type of information absent a reasonable, legitimate purpose for doing so risk violating antitrust laws since such information sharing can be used as evidence of an implicit illegal agreement. In limited circumstances, such as when companies are evaluating a merger, acquisition or joint venture proposal, the sharing of limited competitively sensitive information may be lawful provided it is reasonably necessary to evaluate the proposed transaction and appropriate precautions are taken. Additionally, the Agencies have indicated that an information exchange may be lawful if:

- "a neutral third party manages the exchange,
- the exchange involves information that is relatively old,
- the information is aggregated to protect the identity of the underlying sources, and
- enough sources are aggregated to prevent competitors from linking particular data to an individual source."

Practical Guidance

Companies should consider the Agencies' Guidance as a warning that human resource professionals are not immune to the antitrust laws. Often, HR departments are viewed as having a low risk of antitrust exposure and may not be considered a high priority for antitrust compliance and training. Additionally, organizations that view themselves as having little exposure to violations of antitrust law—such as nonprofits and universities—should heed the Agencies' warning and ensure that their management and personnel are appropriately educated on the antitrust laws. HR departments should be included in antitrust audits. Accordingly, all companies should review their compliance programs and ensure that they contain the following elements, at a minimum:

1. Education and training programs for all management and employees with HR responsibilities. Training for HR personnel can be narrowly targeted to emphasize best practices for external communications related to employee information and the severe consequences associated with inappropriate agreements or disclosures. In particular, the company's compliance standards and procedures should be effectively communicated and readily available to HR professionals. In this regard, it may be helpful to distribute the Agencies' "Antitrust Red Flags for Employment Practices" quick reference card to all management and HR personnel.
2. Proactive reviews of any agreements with other employers related to employment issues. If any agreements raise concern, consulting antitrust counsel immediately may assist in limiting a company's exposure.
3. Effective communication of the risks to both the company and individuals associated with naked wage-fixing, no poaching agreements, and sharing of competitively sensitive employment information to management, HR personnel, and company representatives. Individuals whose roles expose them to competing employers, such as through trade association involvement, should be especially aware of the significant exposure that can result from oral exchanges of competitively sensitive employment terms.

As evidenced above, in certain circumstances, competing employers might have legitimate purposes for sharing competitively sensitive information or entering into employment-related agreements. If you believe that you might fall within this category, first document the legitimate business justification for your policy or practice and then seek the opinion and guidance of antitrust counsel.

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BUSINESS LAW TODAY

Delaware Insider:

Don't Let the Name Fool You: Delaware Statutory Trusts Are Controlled by Contract

By Michael S. Swoyer

The Delaware Court of Chancery has recently reiterated that "[w]hen considering the rights of persons who choose to invest in alternative entity structures . . . it always must be kept in mind that the express policy of [Delaware] is to give maximum effect to the principle of freedom of contract." *Dieckman v. Regency GP LP*, 2016 WL 1223348, at *11 (Del. Ch. Mar. 29, 2016). In support of this proposition, the Court cited provisions of the Delaware Limited Liability Company Act, 6 *Del. C.* §§ 18-101 et seq. (the LLC Act) and the Delaware Revised Uniform Limited Partnership Act, 6 *Del. C.* §§ 17-101 et seq. (DRULPA), which set forth the same principle of freedom of contract. It has become a well-known and oft-repeated fact that Delaware's most popular alternative entities, the limited liability company (LLC) and the limited partnership (LP), offer parties broad contractual authority to vary the terms of their governing statutes. Not as well-known, however, is that the same principle applies to a less commonly used third type of alternative entity, the Delaware statutory trust.

A Delaware statutory trust is an independent legal entity created under the provisions of the Delaware Statutory Trust Act, 12 *Del. C.* §§ 3801 et seq. (the DSTA). The DSTA provides significant flexibility with regard to a statutory trust's governance, operations, and purposes. Similar to the LLC Act and DRULPA, Section 3825 of the DSTA provides that "[i]t is the policy of this subchapter to give maximum effect to the principle of freedom of contract and to the enforceability of governing instruments." Although Delaware courts addressing freedom of contract in the alternative entity context have treated LLCs and LPs interchangeably and consistently upheld the contractual terms of their governing instruments, there is very limited Delaware case law addressing the extent of contractual freedom under the DSTA.

In *Grand Acquisition, LLC v. Passco Indian Springs DST*, 145 A.3d 990 (Del. Ch. 2016), the Delaware Court of Chancery was presented with a rare opportunity to address this issue. Specifically, the court was asked to determine whether a contractual right to inspect the books and records of a statutory trust trumped the statutory defenses and preconditions for inspection set forth in Section 3819 of the DSTA. The court, relying on established Delaware LLC and LP law, determined that the contractual language of a statutory trust's governing instrument created a separate, distinct right of inspection that displaced the DSTA's default inspection preconditions and rendered the DSTA's defenses inapplicable.

The remainder of this article will briefly discuss the "freedom of contract" policy and the preconditions of inspection and defenses under Section 3819 of the DSTA. It will then examine the Court of Chancery's decision in G*rand Acquisition* and provide several key takeaways.

Freedom of Contract within the Delaware Alternative Entity Context

Each of Delaware's alternative entity statutes allows parties significant flexibility to privately order their affairs by structuring each alternative entity's governing instrument. In fact, the LLC Act and the DSTA are modeled directly on DRULPA, the policy of which "is to permit partners to have the broadest possible discretion in drafting their partnership agreements and to furnish answers only in situations where the partners have not expressly made provisions in their partnership agreement or where the agreement is inconsistent with mandatory statutory provisions." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 170 (Del. 2002) (internal quotations omitted). Given a Delaware court will look to statutory default rules for guidance

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only in such limited circumstances, parties seeking a remedy are generally limited to relying upon the terms of the alterative entity's governing instrument.

Section 3819 of the DSTA

Section 3819(a) of the DSTA sets forth certain preconditions that a beneficial owner of a statutory trust must satisfy in order to obtain the records of the trust, unless the governing instrument of the trust dictates otherwise. Section 3819(a) provides:

> *Except to the extent otherwise provided in the governing instrument of a statutory trust*, each beneficial owner of a statutory trust . . . has the right, subject to such reasonable standards . . . as may be established by the trustees . . . , to obtain from the statutory trust [certain categories of information related to the affairs of the statutory trust] from time to time upon reasonable demand for any purpose reasonably related to the beneficial owner's interest as a beneficial owner of the statutory trust . . . .

Section 3819(c) of the DSTA provides the trustee of a statutory trust the right to keep confidential information it in good faith believes is not in the best interest of the statutory trust to reveal, unless the governing instrument of the trust specifies otherwise. Specifically, Section 3819(c) states:

> *Except to the extent otherwise provided in the governing instrument of a statutory trust*, the trustees . . . of the statutory trust shall have the right to keep confidential . . . any information [they] reasonably believe to be . . . information the disclosure of which [they] in good faith believe is not in the best interest of the statutory trust or could damage the statutory trust or its business . . . .

Grand Acquisition, LLC v. Passco Indian Springs DST

Summary of Facts

On September 30, 2015, Grand Acquisition, LLC (GA), a beneficial owner of Passco Indian Springs, a Delaware statutory trust (the Trust), sent the Trust a letter demanding to inspect a current list of the Trust's beneficial owners, the beneficial owners' contact information, and each beneficial owner's respective interests in the Trust (collectively, the Requested Information). The Trust denied GA's demand and requested that GA provide a reasonable basis for its demand that was sufficiently related to its ownership interest in the Trust.

On December 18, 2015, GA sent a supplemental demand letter to the Trust stating that it need not have a reasonable basis for its demand because Section 5.3(c)of the Amended and Restated Trust Agreement (the Trust Agreement) effectively eliminated all preconditions to inspection under Section 3819. Section 5.3(c) provided beneficial owners of the Trust with the right to "inspect, examine and copy the Trust's books and records," as long as the examination took place "during normal business hours." The Trust failed to respond to GA's supplemental demand letter.

On February 16, 2016, GA filed a verified complaint in the Court of Chancery seeking to inspect the Requested Information. After discovery, both parties agreed to resolve the case through cross motions for summary judgment.

Parties' Arguments

GA contended, *inter alia*, that Section 5.3(c) of the Trust Agreement provided GA with an unfettered contractual right to inspect the books and records of the Trust that displaced the preconditions of Section 3819.

In response, the Trust contended that preconditions of Section 3819 applied because Section 5.3(c) failed to "affirmatively disavow" them. The Trust based this argument primarily on the meaning of the prefatory phrase appearing in Section 3819(a) and (c), which provides: "Except as otherwise provided in the governing instrument." This phrase had been interpreted in a prior Court of Chancery decision to mean that "in the absence of language in the governing instrument . . . *to the contrary*," the DSTA's default statutory provisions apply. *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1116 (Del. Ch. 2008). The Trust, relying on this interpretation, argued that the language of Section 5.3(c) was not "contrary" to Section 3819 because it did not "expressly disclaim" the preconditions and defenses contained in Section 3819.

The Trust also relied upon Section 18-305 of the LLC Act and Section 17-305 of DRULPA for support of its position. These sections of the LLC Act and DRULPA set forth the right to inspect books and records of a Delaware LLC or a Delaware LP. Sections 18-305 and 17-305 are nearly identical to Section 3819 of the DSTA, but do not contain the same prefatory clause as Section 3819. Based upon this distinction, the Trust argued that "unlike the LLC Act and [DRULPA], the [DSTA] *does* provide a series of default provisions for a books and records action, each of which the governing document *must* expressly alter."

Finally, the Trust argued that even if GA had a contractual right to inspect the Requested Information under the Trust Agreement, it was not entitled to inspect the Requested Information because the purpose of the inspection was improper. The Trust argued that this common law defense, known as the contractual "improper purpose defense," was applicable because GA was seeking to inspect the Requested Information for a personal reason harmful to the interests of the Trust.

Court's Analysis

At the outset of its analysis, the court noted that in the LLC and LP context, "a contractual books and records right provided in an [LLC's] or [LP's] governing instrument [is] independent from the relevant default statutory right." In the same context, "providing an entity's owners with an unconditional contractual right to inspect that entity's books and records has the practical impact of rendering the relevant statutory preconditions and defenses inapplicable to that independent contractual right." Although these principles had only been relied upon in the LLC and LP contexts, the court determined that they applied equally to statutory trusts because the DSTA shares the same policy of maximizing freedom of

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contract as the LLC Act and DRULPA. The court then turned to the parties' arguments to determine whether Section 5.3(c) created an unconditional contractual right to inspect the Requested Information.

First, the court rejected the Trust's contention that the prefatory phrase found in Section 3819 required an express disclaimer in the Trust Agreement of Section 3819's preconditions and defenses. Rather, the Court found that to disclaim default provisions of the DSTA, the Trust Agreement need only contain contractual language "contrary" to the statutory language. The court determined that Section 5.3(c), which expressly permitted beneficial owners of the Trust to "inspect, examine and copy the Trust's books and records," subject only to the condition that such actions be taken "during normal business hours," was clearly contrary to Section 3819.

Additionally, the court observed that although Section 18-305 and Section 17-305 do not contain the same prefatory clause as Section 3819, the LLC Act and DRULPA include provisions that expressly permit the respective entity's governing instrument to limit an owner's right to inspect the entity's books and records. Specifically, Section 18-305(g) of the LLC Act and Section 17-305(g) of DRULPA allow an LLC or an LP to restrict a member's or partner's right to inspect any of the books and records of the LLC or LP. Notably, Section 3819 of the DSTA contains no such provision. The court accounted for this distinction by concluding that the prefatory phrase in Section 3819 served the same purpose as Section 18-305(g) and Section 17-305(g). In other words, the court found that the prefatory phrase in Section 3819 permits the governing instrument of a statutory trust to limit the right of beneficial owners to inspect the books and records of the statutory trust.

Finally, the court noted that the "improper purpose defense" had only ever been applied in the LP context and that its application in the statutory trust context was an "open issue." Nevertheless, the court determined that it need not address the issue because even if the defense was applicable, the Trust failed to prove that releasing the Requested Information to GA would cause the Trust actual harm.

Takeaways

Governing Instrument of a Statutory Trust Trumps the Default Provisions of the DSTA

Similar to a Delaware LLC or LP, a statutory trust is primarily a creature of contract, governed first by its respective trust agreement and secondarily by statute. In lieu of applying the statutory defaults of the DSTA, Delaware courts will defer to the parties' rights as agreed upon in a trust agreement. *Grand Acquisition* illustrates that when addressing an issue related to the freedom to contract in the statutory trust context, Delaware courts may look to, and directly apply, LLC and LP precedents to render a decision. Practitioners must be cognizant of this possibility and consult Delaware LLC and LP law when drafting the governing instrument of a statutory trust.

"Contrary" Language Need Not Be an Express Disclaimer of a Statutory Default

A contractual right or obligation in a statutory trust's governing instrument that is "contrary" to a statutory default of the DSTA will displace that statutory default. *Grand Acquisition* makes clear that contractual language need not expressly disclaim or affirmatively disavow a statutory default to be considered "contrary." Rather, "contrary" language encompasses a broader spectrum, which includes language that is incompatible or inconsistent with a statutory default. Thus, if the intent of the contractual provision is to merely clarify or create conditions in addition to a specific statutory right, the governing instrument must expressly state such purpose.

Statutory Defaults Should Be Expressly Incorporated into the Trust's Governing Instrument

Parties seeking to form a statutory trust subject to certain default provisions of the DSTA must carefully draft the Trust's governing instrument to exclude any and all provisions that may be considered "contrary" to those statutory defaults. However, relying on what the parties perceive to be the absence of any term "contrary" to the relevant statutory defaults is an uncertain endeavor. By doing so, the parties leave open the door for a court to interpret whether any term of the governing instrument is "contrary" to the statutory default. For the avoidance of doubt, parties should expressly incorporate into the statutory trust's governing instrument the default provisions of the DSTA that they wish to apply.

It is Unclear to What Extent LLC and LP Precedents Will Apply in the Statutory Trust Context

In *Grand Acquisition*, the Delaware Court of Chancery applied established principles of LLC and LP law to determine that the terms of the Trust Agreement trumped the default rules of the DSTA. However, when asked to confirm the application of the contractual "improper purpose defense" to a statutory trust, the court avoided doing so despite the defense being applicable in the LP context. Thus, although the *Grand Acquisition* decision demonstrates that LLC and LP precedents may be applied to contractual issues involving a statutory trust, the extent of their application is not entirely clear.

Significantly, the DSTA does not preempt common law principles related to trusts. In fact, Section 3809 of the DSTA explicitly subjects Delaware statutory trusts to trust common law unless otherwise provided in the statutory trust's governing instrument or the DSTA. The interplay between the application of trust common law and LLC and LP precedents to Delaware statutory trusts is an interesting issue that should be monitored as statutory trust law continues to evolve.

Conclusion

The Court of Chancery's decision in *Grand Acquisition* illustrates the analysis Delaware courts will undertake in order to determine whether the statutory framework of the DSTA has been displaced by a trust's governing instrument. This analysis may include application of LLC and LP precedents due to the DSTA's shared policy of

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maximizing freedom of contract and the lack of case law involving Delaware statutory trusts. As in the realm of Delaware LLCs and LPs, it is the governing instrument of the statutory trust that controls when a conflict arises with the DSTA. Accordingly, practitioners seeking to maintain statutory defaults must take care to ensure that the statutory framework of the DSTA will apply by omitting any language to the contrary in the trust's governing instrument or by expressly incorporating the desired DSTA default provisions.

Michael S. Swoyer is an associate with the Delaware Counsel Group, LLP in Wilmington, Delaware, where he practices in the areas of corporate, alternative entity, and trust law. *The author would like to thank Ellisa O. Habbart, managing partner of the Delaware Counsel Group, LLP, for her helpful comments in drafting this article.*

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BUSINESS LAW TODAY

Member Spotlight:

An Interview with Justice Henry duPont Ridgely

After more than 30 years of service as a jurist in the Delaware Judiciary, Justice Henry duPont Ridgely is a walking library of Delaware business law decisions. During his tenure on the Supreme Court of Delaware, he participated in more than 700 published opinions, including every major decision issued during his time on the bench involving directors' and officers' liability, merger and acquisition disputes, and contests for corporate control. During his leadership of the Delaware Superior Court, Delaware was first recognized by the U.S. Chamber of Commerce as first among the 50 states for the fairness and reasonableness of its litigation environment. Delaware is still number one today.

Now he is Senior Counsel at DLA Piper in Wilmington, Delaware, and a Business Law Advisor to the Business Law Section. In addition to a busy practice, he has traveled internationally as part of DLA Piper's pro bono initiatives to share his experience and help countries improve their court systems, using best practices consistent with the rule of law.

* * *

You've served for over a decade at the Justice of the Delaware Supreme Court and more than 30 years as a jurist in the Delaware Judiciary. Did you always aspire to become a judge?

No, I did not. When I was growing up, I aspired to be a lawyer like my late father, Henry J. Ridgely, who was a distinguished solo practitioner in Dover, Delaware. I would go to his office as a child and admire him and the work he did. My original intention was to join him in the practice of law for the rest of my professional life. After law school, I returned home to Delaware and did practice with him and enjoyed it. It was 10 years later in 1984 when a lawyer I knew and respected, asked me to consider becoming a judge. I thought about it and only then aspired to join the Delaware Judiciary. With my father's encouragement and blessing, I applied for and was nominated by the governor and confirmed by the Senate as a Superior Court Judge. I served there for 20 years, including 14 years as President Judge, and thereafter for more than 10 years on the Delaware Supreme Court.

What did you enjoy about serving as a justice and a judge?

I enjoyed the variety of challenges that accompanied trial and appellate work, the engagement with skilled lawyers, and I enjoyed problem solving in individual cases. No case was ever exactly like another. I worked with great judges and staff in Delaware. There is a special collegiality among Delaware judges and I received an early lesson in that. When I first joined the Superior Court, the judges made it clear to me that as a new judge we were all working together to do what was right and to achieve justice in our state. If I had a question as a new judge about anything, I could call another judge and even ask another judge to step down from the bench to speak with me. I did not hesitate in doing that. I gave the same advice to new judges who became judges after I did.

Was there anything you didn't enjoy about your position?

There were only two aspects of my work over the years that I did not enjoy, though they were a necessary part of my duties: sentencing and attorney discipline.

What advice would you give to a lawyer who aspires to become a judge?

First, get the legal knowledge and experience you need in your chosen legal field. Sharpen your analytical skills and be very sure to practice law with civility and professionalism. Always show the highest

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level of integrity. Second, develop a reputation for fairness and be actively involved in pro bono work and other community service. When candidates are considered for judicial office, whatever the selection process may be, those making the selection are more likely to select a candidate who is not only well qualified through knowledge and experience, but who also has the balanced temperament and ability to listen required for the job. And third, demonstrate that you can be trusted with the awesome power given to judges and justices under our system.

What three adjectives would you choose to describe an ideal judge?

Fair, open-minded, and thoughtful. A judge needs to have the highest integrity and must be honest and impartial in everything that he or she does.

You participated in more than 700 published opinions. Was there an area of corporate law that dramatically changed during your time as a justice?

The biggest corporate law change during my time on the Supreme Court related to the facial validity of forum selection clauses in certificates of incorporation and bylaws. Multi-jurisdiction litigation is expensive and time consuming for companies and shareholders alike. I remember early in my tenure as a Justice the so-called ABC rule being discussed: ABC stood for "Anywhere But Chancery." Cases were being filed not just in Delaware, but, also in multiple states. Companies reacted to this by developing forum selection bylaws, selecting Delaware exclusively for the resolution of internal corporate governance claims. At first there was skepticism about the validity of these bylaws. This type of bylaw was held to be facially valid by then chancellor, now Chief Justice Strine, in the landmark *Boilermakers* case. Important precedents that he cited in his careful analysis in *Boilermakers* were *Airgas, Inc. v. Air Products*, where the Supreme Court made clear that bylaws are part of a binding contract among directors, officers and shareholders and *Ingress v. CA, Inc*. where the Supreme Court explained that forum selection clauses in contracts are presumptively valid and should be specifically enforced through an injunction. An appeal of *Boilermakers* was taken to the Delaware Supreme Court but was voluntarily dismissed before we could decide it. Other courts across the country have since cited *Boilermakers* with approval in upholding the facial validity of forum selection bylaws.

Ultimately, in 2015, the Delaware General Assembly expressly authorized forum selection bylaws and charter provisions by statute. Although there are aspects of forum selection jurisprudence still being resolved, this dramatic new approach promotes not only cost savings but also consistency and clarity in the application of Delaware corporate law.

Because of this, is the Delaware court system that much more savvy regarding business litigation?

Absolutely. That has been the case for a very long time. More than two-thirds of Fortune 500 companies are incorporated in Delaware, and so are more than half of the companies listed on the New York Stock Exchange. Name a big U.S. company and you will probably find it is a Delaware company. This can be traced back to the early 1900s when companies moved their corporate homes from New Jersey and other states to Delaware in reaction to legislative initiatives of then Governor Woodrow Wilson in New Jersey. Delaware has a flexible and modern general corporation law and a judiciary that has become specialized in this area over the years. The body of Delaware case law, the flexibility of our Delaware General Corporation Law, the expeditious service by our Division of Corporations, and the quality of the Delaware Bar and Judiciary continue to make Delaware the best choice for where to incorporate. In 2015, 86 percent of all new U.S. initial public offerings were incorporated in Delaware.

Delaware judges have led the way in making corporate law, so Delaware law is, in effect, the national corporate law of the United States. Delaware corporation law is what is taught in law schools as a result of this leadership. And when there is an international discussion of corporate governance in the world, Delaware is generally represented at that conference for the discussion to be complete.

You were chair-elect of the National Conference of State Trial Judges. What were your responsibilities and what did you set out to accomplish?

This was a role I did not have for very long because of my appointment to the Delaware Supreme Court. As chair-elect, I served on the executive committee and was in line to become the chair of the National Conference of State Trial Judges without further action by the conference. My service as chair-elect came to a sudden end when I was appointed as an appellate judge. Had I continued as chair, my intention was to continue the conference's important role in recommending ABA standards relating to court organization and trial court administration. ABA standards are, and continue to be, a very important resource for trial and appellate judges everywhere.

For example, while I served with the National Conference of State Trial Judges, three ABA standards addressing best practices in establishing and operating drug treatment courts, electronic filing in the courts, and in addressing court automation within the courts were unanimously adopted by the ABA House of Delegates. That happened based upon the work of our Conference and ABA Judicial Division committees.

In 2015, the governor of Delaware awarded you the Order of the First State, the highest recognition that a Delaware governor can give for outstanding efforts, knowledge, integrity, prudence and ability in serving the State of Delaware. Where were you when you heard about this honor and how did you feel?

I was at the governor's northern residence in Delaware. It's a home and conference center called Buena Vista where state dinners are held. I was there for my retirement dinner with my family and all of the judges, justices and my office staff that I had served

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with who could be there. I felt deeply grateful and honored to receive the award. I was especially happy that my colleagues, staff and my family were there with me. I felt that anything I accomplished could only have been done with their help and support.

In 2015 you joined DLA Piper. What was unexpected in terms of transitioning to private practice?

I did expect certain changes, like keeping track of billable and non-billable hours again and assuming the role of a strategic advisor for trial and appellate litigation. But what I did not expect was how at home I would feel in making this transition and in working with lawyer advocates. The practical effect is I am still doing the legal research I enjoy on interesting aspects of the law. I'm still doing legal writing and editing. And I'm still talking with very talented lawyers about the law and merits of particular cases. So, the ease of transition was something that was a bit unexpected, but not entirely unexpected. I knew I would be made to feel welcome and I have, indeed, felt very welcome at DLA Piper.

What do you enjoy about private practice?

I enjoy the people I work with and the opportunity to be involved with lawyers from around the country and around the world. In particular, I enjoy assisting on matters that are novel legal issues before the Delaware courts. I also enjoy the pro bono opportunities that DLA Piper's global platform has provided. DLA Piper is a pro bono leader in supporting access to justice and the rule of law around the world.

In August of 2016, I traveled to Nairobi, Kenya, along with other DLA Piper lawyers and staff. We taught judges from Kenya, Uganda, Tanzania, and Burundi about business courts and how to handle complex commercial litigation. In Delaware we're accustomed to having judges from other countries visit, but it's usually only for a day. They visit to see how the courts that are rated number one by the U.S. Chamber of Commerce operate. Our program in Nairobi was for five working days and much more in depth than a one day visit. I felt fortunate to teach and share my experiences, to learn from theirs, and to spend an extended period of time with judges from other nations. Judges around the world face many similar issues, from lack of resources to the complexity of litigation. Teaching judges from other nations is an experience I will always remember.

Since Nairobi, I participated in September of 2016 at a conference on good practices for the quality of justice sponsored by the Supreme Court of Montenegro. This was attended by members of the European Union Supreme Courts and EU candidate states supreme courts. In December of 2016, I participated in another conference in Bratislava, Slovakia. The Supreme Court of the Slovak Republic invited me to be a plenary speaker at an international conference where transparency in the courts and its limits was discussed over two days. The president of the Supreme Court of Slovak Republic, the president of the Court of Justice of the European Union and I briefed the media in Slovakia about the importance of that international conference. I give an American perspective at each conference I attend to help judges of other nations improve their court systems. All of this work has been part of the pro bono initiatives that DLA Piper has allowed me to do through its New Perimeter program.

You've given many lectures over the years. Is there one lecture or country where you lectured that stands out for you?

They all do, but an early impression is often the lasting one. I was invited in 2012 to speak to judges of the Russian commercial courts during an Asia-Pacific Conference in Vladivostok, Russia sponsored by the Supreme Commercial Arbitration Court of the Russian Federation. The conference was about best practices in corporate governance and I represented a perspective from the United States. I spent part of that visit with the commercial court trial judges in Vladivostok who asked me to speak about the subject of piercing the corporate veil, specifically about when the corporate formalities can be set aside by a court so that liabilities can be imposed directly on shareholders. They were struggling with these and other issues that were new to them because private corporations came into existence there in the 1990s after the end of the Soviet Union. So they were very interested in my help. I enjoyed exchanging views and learning about how hard they were working to make their court system better. That's a common theme among judges I have met around the world. With economic development at stake, there are both pressures and incentives for court systems to improve, and that's a good thing for the people who live there, and the businesses that invest there.

What is the value of the ABA to you?

Very significant. I've been a member of the ABA, either, as a lawyer or as a judge for decades. My involvement has been with the Judicial Division's National Conference of State Trial Judges and the Appellate Judges Conference and also with the Business Law Section. It was an honor to represent the Appellate Judges Conference for six years in the ABA House of Delegates. Now, I am even more involved with the Business Law Section as a Business Law Advisor, which is another special honor and privilege for me.

I've attended countless hours of Continuing Legal Education programs offered by the ABA. These programs made me a better lawyer and a better judge. I was happy, and continue to be happy, to give back to the ABA and to its CLE programs, by sharing my experiences and by working with outstanding lawyers and judges within the ABA to improve the administration of justice.

Along the way, I have made friends from across the country and I look forward to seeing them at every meeting I attend. I frankly cannot imagine the practice of law or judging without the professional guidance that's available from the American Bar Association.

What advice would you give to a young attorney who's just starting out?

Join your local bar association and join the ABA. It is critical for you to find one or more mentors to help you as a young attorney. There are mentors available in the ABA,

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in your own community, in your own firm and in local chapters of the American Inns of Court. Mentors and ABA CLE programs, will provide you knowledge not only about the law but also an understanding of the ethical obligations that all of us must live by as lawyers and judges. You will be a better lawyer or judge by always continuing to learn. In the old days, everyone studied law under an experienced lawyer, much like an apprentice. As the size of the Bar has grown, that individual guidance can be more difficult to find. As a young lawyer, you must seek it out and one place to find that guidance is the ABA.

What do you do for fun?

I have a home at the beach in Delaware. I enjoy beach life and travel with my wife and my family. I do some surf fishing, not much catching, as well as play golf when I can.

Thank you so much!

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BUSINESS LAW TODAY

Inside Business Law

In this issue of "Inside Business Law," we provide links to register for several upcoming stand-alone committee meetings that will be held in January as well as the Section Spring Meeting that will be held in New Orleans in April.

Register for an Upcoming Committee Meeting or the Section Spring Meeting

2017 Banking Law Committee Meeting

The Banking Law Committee will meet January 5–7 at the Ritz-Carlton, Washington DC. You may register for the meeting here, and view the draft agenda for the meeting here.

2017 Consumer Financial Services Committee Meeting

The Consumer Financial Services Committee will meet January 12–15 at the Park Hyatt Aviara Resort, Golf Club & Spa in Carlsbad, California. While the meeting agenda is subject to change, you may view the agenda here, and register for the meeting here.

2017 Derivatives and Futures Law Committee Meeting

The Derivatives and Futures Law Committee will meet January 19–21 at the LaPlaya Beach & Golf Resort in Naples, Florida. The meeting agenda is available here, and you may register for the meeting here.

2017 Mergers and Acquisitions Committee Meeting

The Mergers and Acquisitions Committee will meet January 27–28 at the Montage Laguna Beach in Laguna Beach, California. The agenda for this meeting is currently being developed, but the full committee meeting is tentatively scheduled to take place on Saturday, January 28, from 3:00 to 5:30 pm PST. You may register for the meeting here.

2017 Cyberspace Law Institute and Winter Working Meeting

The Cyberspace Law Committee will meet January 27–28 at the US Grant, A Luxury Collection Hotel, in San Diego, California. The agenda is being developed but a quick view of the tentative schedule is available here. You may register for the Institute and Winter Working Meeting here.

2017 Section Spring Meeting

Registration for the 2017 Business Law Section Spring Meeting, which will be held from April 6 to 8 in New Orleans, Louisiana, is now open. The Spring Meeting will be held at the Hyatt Regency New Orleans. The Spring Meeting will offer attendees the opportunity to:

- Expand your knowledge to stay on the cutting edge of the law and learn from the experts from over 90 CLE programs
- Design your experience to connect with thought leaders at substantive meetings and social events
- Collaborate with professionals in every practice area
- Build your network with corporate counsel, private practitioners, judges and regulators
- Experience committee dinners hosted at restaurants throughout New Orleans

Early bird registration, which will be available until March 3, 2017, can be found here. *Laissez les bons temps rouler!*

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