Feature Articles

- **Our Mini-Theme: Recent Developments in Business and Corporate Litigation 2017**

- **Conducting Business with Tribes in the Aftermath of the Dollar General Supreme Court Split: What You and Your Clients Need to Know**
  This article focuses on the Supreme Court’s split decision in its June 2016 Dollar General ruling by examining the history leading to the decision and analyzing its implications for conducting business on tribal land.

- **The Defend Trade Secrets Act: One Year Later**
  The Defend Trade Secrets Act of 2016 was signed into law by former President Obama and became effective on May 11, 2016, amid much fanfare. At the time of its passage, the law was described as the “most significant expansion” of federal law in intellectual property since the Lanham Act in 1946. This article provides an overview of the recent developments in DTSA trade secret litigation over the course of the past year.

- **Authenticating Digital Evidence at Trial**
  In this digital age, social media, texts, and a variety of other forms of technology have increasingly become evidence, or sought as evidence, in a wide sundry of litigation. How do you ensure that this evidence comes in at trial? Although it may appear more complicated at first glance, the short answer is simple: authentication. As with all other types of evidence, digital evidence must be authenticated in order to be properly introduced at trial. However, authenticating digital evidence can pose some interesting challenges.

- **Private Planes, Investors, and NASDAQ Rules: Delaware Supreme Court Gives Guidance on Director Independence**
  In Sandys v. Pincus, the Delaware Supreme Court found that certain corporate directors were not independent for purposes of pleading demand futility in a derivative suit. The court based its ruling on: (1) mutual ownership of an airplane; (2) “mutually beneficial business relations”; and (3) not being identified as independent under NASDAQ rules.
Other Feature Articles

- **Ten Rules Every Lawyer—and Client—Should Know about Taxes on Legal Settlements**
  
  Lawyers and clients resolve disputes all the time, usually with an exchange of money and a release. Almost any time money changes hands, there are tax issues for both sides, coming up in a surprising number of ways. This article provides 10 rules lawyers and clients should know about the taxation of settlements.

- **What Constitutes a Security and Requirements Relating to the Offer and Sales of Securities and Exemptions From Registration Associated Therewith**

  Many people are not aware of the requirement that all sales of securities either need to be registered with the SEC or there needs to be an exemption from registration. This article includes information regarding what constitutes a “Security” and registration of shares with the SEC, as well as exemptions that can be utilized to avoid the registration requirement.

- **Allergan Fine Is a Reminder of the Obligation to Disclose White-Knight Negotiations Following an Unsolicited Tender Offer**

  Allergan Inc. agreed with the SEC that it will admit to securities law violations and will pay a $15 million fine for disclosure violations relating to its Schedule 14D-9 filed in response to the unsolicited tender offer for Allergan’s shares by Valeant Pharmaceuticals International plc in 2014. The SEC contended that Allergan failed to disclose that it was engaged in negotiations for a possible acquisition and for a “white knight” transaction in the months following the tender offer. In an article by Fried Frank’s corporate team, the practical issues regarding the disclosure of M&A discussions following a tender offer are discussed and special factors involved in the Allergan situation are noted.

- **Keynote Speaker Mayor Landrieu Details Rebirth**

  Almost 12 years after the costliest disaster in U.S. history, New Orleans Mayor Mitch Landrieu spoke at the Business Law Section 2017 Spring Meeting luncheon in New Orleans on the efforts of his office to rebuild “one of the greatest cities in the world” after Hurricane Katrina. Expounding upon the guiding principles of not just the city of New Orleans, but of the country as a whole, Mayor Landrieu reminded lawyers in the audience of their duty to serve as protectors of those principles during the country’s trying times.

- **New Orleans Diary**

  The 2017 ABA Business Law Section Spring Meeting will be remembered in many ways, among them: 1,600+ members in attendance from around the world; more than 90 programs and sessions; and fabulous networking events that epitomized the NOLA experience. Here are a few highlights from some of the members themselves.
• **KEEPING CURRENT: Hively v. Ivy Tech Community College of Indiana: Title VII Prohibits Sexual Orientation Discrimination**
  
  *Title VII of the 1964 Civil Rights Act prohibits employers from discriminating against employees and job applicants based on five traits, including sex. Since 1994 Congress has often been urged to recognize sexual orientation as a protected trait, as several state laws do, but it has not done so. But on April 4, 2017, the Seventh Circuit Court of Appeals held en banc that Title VII outlaws sexual orientation discrimination.*

• **ETHICS CORNER: Inadvertent Disclosure—Traps Await the Unwary**
  
  *This article delves into complications surrounding inadvertent disclosure and provides answers to some of the most pressing questions regarding inadvertent disclosure.*

• **MEMBER SPOTLIGHT: An Interview with Therese Franzén**
  
  *Therese Franzén has delved into nearly every corner of the law—working as a prosecutor, a partner at a firm, a general counsel, and cofounder of a firm and also a company, a mortgage quality control and compliance company. She’s also found time to do pro bono work in Mexico, Haiti, and her hometown of Peachtree Corners, Georgia. Throughout, the ABA has been critical to her legal career.*

• **INSIDE BUSINESS LAW**
  
  *This month’s “Inside Business Law” highlights the five most in-demand programs from the 2017 Business Law Section Spring Meeting held in New Orleans, Louisiana, April 6–8.*
The Business and Corporate Litigation Committee is pleased to present its annual mini-theme issue of Business Law Today. The breadth of business litigation faced by today’s companies is staggering. So, too, is the attendant cost and risk. The Business and Corporate Litigation Committee (BCLC) is the home within the ABA Business Law Section (BLS) for lawyers, in-house counsel, judges, and law students interested in dispute resolution, including litigation, arbitration, and mediation for business clients, as well as substantive issues for business litigators. Our members from around the United States and beyond are approximately 2,000 strong, making the BCLC one of the ten largest committees in the BLS. We have approximately 35 subcommittees in which you can develop your knowledge, connections, and leadership.

To join our growing committee, any BLS member may join the BCLC for free here. Many of our members have found an opportunity to flourish as authors, to show their expertise in particular areas of the law. For example, the BCLC has, for numerous years, authored the indispensable Recent Developments in Business and Corporate Litigation (formerly the Annual Review). The 2017 edition contains 19 chapters authored by over 150 committee members. This single volume—which you can purchase here—is divided into five parts:

1. Litigation and Dispute Resolution Practice
2. Civil Business Claims
3. Business Associations Law
4. Employment & Labor Law
5. Finance & Securities Litigation & Arbitration

Committee members regularly write articles for the Section’s Business Law Today publication, as evidenced by this mini-theme issue. These articles represent hot legal topics including (1) the Defend Trade Secrets Act; (2) conducting business on Native American lands after the Supreme Court decision in Dollar General; (3) recent developments in the Delaware Supreme Court on director independence; and (4) authenticating digital evidence at trial. In addition, the BCLC has its own newsletter—The Network—which offers further writing opportunities for committee members.

The BCLC takes great pride in its quality programming and special events. The committee participates actively in the BLS Spring, Annual, and Fall Meetings, and it typically presents 11 CLE programs annually. BCLC regularly presents non-CLE programs and special events, such as the Tips from the Trial Bench program, the Woman Business and Commercial Advocates Reception, and the Annual Pro Bono and Public Service Project. Our popular committee dinners held at each meeting are regularly co-sponsored by the Judges’ Initiative Committee and ADR Committee.

If you missed the Section Spring Meeting in New Orleans, please join us at the Section Annual Meeting in Chicago on September 14–16. The benefits of the BCLC are many, and your experience can be tailored to your individual practice and needs. We are an inclusive and collaborative group—please check out the BCLC webpage here. I hope to see you soon at a future meeting!

Heidi McNeil Staudenmaier
Chair, Business and Corporate Litigation Committee
Introduction
With the U.S. Supreme Court’s 4–4 split in Dollar Gen. Corp. v. Mississippi Band of Choctaw Indians, 136 S. Ct. 2159 (2016), tribal members and nonmember individuals and businesses are left to wonder who really wins in this tie. The split decision provided no written opinion and operates as an affirmation of the Fifth Circuit’s decision upholding the jurisdiction of the Mississippi Band of Choctaw tribal court over tort claims brought by a member of the Choctaw tribe against a corporation doing business on reservation land. This decision serves as a significant reminder that anyone doing business on tribal lands must be cognizant that tribal court jurisdiction likely may apply over any disputes that arise.

Overview of Tribal Jurisdiction
Over 30 years ago, the U.S. Supreme Court created two exceptions to the general rule that Indian tribes cannot exercise civil jurisdiction over nonmembers in Montana v. United States, 450 U.S. 544, 565–66 (1981). The first of the two Montana exceptions, also known as the “consensual relationship” exception, establishes that a tribe may regulate the activities of nonmembers entering consensual relationships with the tribe or members thereof through “commercial dealing, contracts, leases, or other arrangements.” Methods of such regulation include “taxation, licensing, or other means.”

Despite this evident pronouncement that tribal courts may, under certain circumstances, exercise jurisdiction over nonmembers, approximately 20 years after the Montana decision, the Supreme Court itself recognized that tribal courts had yet to exercise jurisdiction over a nonmember defendant in any context whatsoever, leaving many to question for two decades whether, and under what circumstances, nonmembers may be subject to tribal court jurisdiction. See generally Nevada v. Hicks, 533 U.S. 353 (2001) (finding Montana’s proscriptions to fall short of dispositive in the case “when weighed against the State’s interest in pursuing off-reservation violations of its laws.”).

Dollar General’s Procedural Posture
The factual background of Dollar General sounds in tort. Dolgencorp operates a Dollar General store on the Choctaw reservation in Mississippi, located on land held by the United States in trust on behalf of the Mississippi Band of Choctaw Indians (the Tribe). The Dollar General store is operated pursuant to a lease agreement with the Tribe and a business license issued by the Tribe to Dolgencorp. Dolgencorp, Inc. v. Mississippi Band of Choctaw Indians, 746 F.3d 167, 169 (5th Cir. 2014). The Tribe conducts the Youth Opportunity Program (YOP), a project which places young members of the Tribe in short-term, unpaid positions—similar to internships—for educational and training purposes. The manager of the Dollar General store, Dale Townsend (Townsend), agreed to participate in this program. Townsend was not a member of the Tribe. Thereafter, the YOP program placed a 13-year-old tribal member (Doe) at the store. Doe later accused Townsend of sexual molestation.

In January 2005, Doe filed suit against Townsend and Dolgencorp in the Choctaw tribal court, alleging that Dolgencorp was vicariously liable for Townsend’s actions and asserting the store negligently hired, trained, or supervised Townsend. Doe further claimed the assault caused severe men-

For the latest edition of Business Law Today, published in April 2017, you'll find detailed analysis on the latest developments in the field of business law, including updates on cases like Dollar General and their implications for tribal jurisdiction. To access this content, visit the American Bar Association’s website or explore the latest issues of Business Law Today.
Dolgencorp asserted that, because the consensual relationship between Dolgencorp, Townsend, and the tribal parties does not implicate tribal self-governance or internal relations, tribal jurisdiction could not be asserted. Dolgencorp further argued that “tribal sovereignty is subordinate to Congressional authority as a practical matter, and inconsistent with federal concepts of sovereignty.”

The tribal defendants countered that Plains Commerce did not alter the Montana exceptions in any manner, and that a plain showing of a consensual relationship between the tribe and nontribal parties supports a finding of consent to tribal jurisdiction. The Tribe also relied on a contract with Dollar General that “explicitly bound” the corporation to tribal court, arguing further that a sexual assault case addressed tribal health and welfare and thus was clearly subject to tribal jurisdiction.

The Mississippi District Court in Dollar General agreed with the tribal defendants’ arguments in favor of jurisdiction and granted summary judgment in their favor. Dolgencorp Inc. v. Mississippi Band of Choctaw Indians, 846 F. Supp. 2d 646, 653–654 (S.D. Miss. 2011) (“In the court’s opinion, defendants have the better of this argument. Montana identified nonmembers’ consensual relationships with tribes and their members, which involve conduct on the reservation (and particularly on Indian trust land), as a circumstance that warrants tribal civil jurisdiction over matters arising from those relationships.”). The court refused to read any narrowing of Montana’s exception through the Plains Commerce decision and subsequent jurisprudence.

Dolgencorp challenged the district court’s determination that Montana’s consensual relationship exception had been met. However, the Fifth Circuit Court of Appeals affirmed the district court’s decision. In doing so, the court held that Doe was essentially an unpaid intern, unquestionably creating a consensual relationship of commercial nature. Dolgencorp, Inc. v. Mississippi Band of Choctaw Indians, 746 F.3d 167, 173 (5th Cir. 2014) (“In essence, a tribe that has agreed to place a minor tribe member as an unpaid intern in a business located on tribal land on a reservation is attempting to regulate the safety of the child’s workplace. Simply put, the tribe is protecting its own children on its own land. It is surely within the tribe’s regulatory authority to insist that a child working for a local business not be sexually assaulted by the employees of the business.”).

It is important to note that the Fifth Circuit did not establish a commercial relationship as a prerequisite to the assertion of tribal jurisdiction. By rejecting Dolgencorp’s assertion that Plains Commerce narrowed the Montana exception, the appellate court established a higher-level, more general focus when determining an activity’s impact on the Tribe’s interest in regulating the activity.

Fifth Circuit Judge Smith wrote a biting dissent, emphasizing that: (i) Montana’s narrow exception applies only when the conduct questioned is encompassed under a tribe’s authority to “protect tribal self-government or to control internal relations”; and (ii) even if this initial barrier had been met, the nexus between Dolgencorp’s participation in the YOP and the full body of Indian tort law was too weak to permit tribal jurisdiction over Dolgencorp. Judge Smith opined that Dolgencorp could not have anticipated that its consensual relationship with Doe via the YOP program would subject it to any and all tort claims actionable under tribal law; thus, an insufficient nexus existed to satisfy Montana’s first exception. He postured that this first exception “envisages discrete regulations consented to ex ante; the majority, to the contrary, upholds an unprecedented after-the-fact imposition of an entire body of tort law based on Dolgencorp’s participation in a brief, unpaid internship program.”

The Supreme Court’s Dollar General Split
The Supreme Court granted a petition for a writ of certiorari to Dollar General and its parent company, Dolgencorp (together, Dolgencorp), to evaluate whether Dolgencorp could be brought under tribal jurisdic-
tion to adjudicate civil tort claims against nonmembers under the first exception enumerated in Montana. See generally Dollar General, 136 U.S. at 2159. The tribal court approached the Supreme Court’s review with unlikely odds, having won only two Supreme Court cases involving tribal interests, compared to nine losses, since 2005. In addition to its wide recognition as a pro-business bench, the Supreme Court itself acknowledged in 2001 that it had never found a tribal court to have jurisdiction against nonmembers under the first Montana exception.

The Tribe, however, did have some support. For example, although the Supreme Court had never held as such, the Fifth Circuit pointed out that, in its view, every circuit court to address whether tribal courts may exercise jurisdiction over tort claims against nonmembers under Montana’s first exception have held or assumed that they may validly do so. Dolgencorp, Inc., 746 F.3d at 173 n.3. Additionally, the Department of Justice (DOJ) filed an amicus brief in support of the Tribe’s positions and supported the Fifth Circuit’s decision that the Tribe had jurisdiction over Doe’s tort claims because it has the ability to regulate conduct occurring on tribal land, irrespective of Montana’s rule or exceptions. Brief for the United States as Amicus Curiae, Dollar General Corp. v. Mississippi Band of Choctaw Indians, 2015 WL 2228553, at 9–10 (U.S.).

On June 23, 2016, the Supreme Court issued its Dollar General ruling, with a 4–4 split decision, affirming the decision of the Fifth Circuit and upholding tribal court jurisdiction over Doe’s tort claims against Dolgencorp. Because of the tie, no written opinion was issued by the court; thus, the decision does not operate as direct precedent outside of the Fifth Circuit (which includes Mississippi, Louisiana, and Texas). Nevertheless, this does provide persuasive precedent for other jurisdictions and “affirms the longstanding legal principle that tribal courts have civil jurisdiction over non-Indian conduct arising from consensual relations on Indian reservations.” Indeed, with the Dollar General decision, the Supreme Court voted three out of three times in favor of upholding tribal sovereignty in major Indian law cases in 2016, including Nebraska v. Parker, 136 S. Ct. 1072 (2016) and U.S. v. Bryant, 136 S. Ct. 1954 (2016). Both Bryant and Dollar General dealt with tribal courts’ ability to protect tribal members from domestic violence and sexual assault.

Notwithstanding the Supreme Court decision, much uncertainty remains as to the scope of tribal jurisdiction over nonmember individuals and organizations conducting business on tribal land. This uncertainty carries the ability to adversely impact both tribes and their business partners. One result of this jurisdictional uncertainty is the potential withdrawal of businesses from operating and transacting on tribal land. For tribal communities “in which unemployment is already high and access to commercial services (like low-cost merchandise stores) is low,” this may be a very real negative consequence of continuing jurisdictional uncertainty. Petition for Writ of Certiorari, Dollar General Corp. v. The Mississippi Band of Choctaw Indians, 2014 WL 2704006, at 17 (U.S.).

Conclusion

The Supreme Court’s decision is quite impactful on business relationships between tribes and companies and individuals seeking to do business with tribes. Dolgencorp’s petition for a writ of certiorari even anticipated the serious implications of the Supreme Court’s future decision, noting that it affects “tens of thousands of nonmember corporations and individuals who do business on tribal reservations.” Dollar General serves to solidify tribal courts’ jurisdiction and ability to protect members from intentional torts committed within the context of an employer/employee relationship when the business is located within tribal land. Because Indian tribes “generally [do not] have criminal jurisdiction over non-Indians,” this affirmation of a tribe’s ability to seek a civil remedy serves as “the only deterrent to unlawful actions committed by non-Indians who are working or doing business on the reservation.” The suit will now continue in tribal court for a hearing on its merits.

As a result of Dollar General, businesses simply must be aware that any disputes arising on tribal lands may be subject to tribal court jurisdiction, and they should familiarize themselves with the court’s rules and procedures.

Heidi McNeil Staudenmaier is a partner in the Phoenix office of the law firm of Snell & Wilmer, where she manages the Native American Affairs practice group and also provides legal representation on gaming and business litigation issues. She is chair of the Business Law Section’s Business & Corporate Litigation Committee, past member of the Section Council, and past editor-in-chief of Business Law Today, as well as a member of the first class of Business Section Fellows.

Hannah K. Speirs is an associate in the Phoenix office of the law firm of Snell & Wilmer, where she practices general litigation with a focus on real estate and other commercial matters. She is a 2016 graduate of the Sandra Day O’Connor College of Law at Arizona State University.
Introduction
The Defend Trade Secrets Act of 2016 (DTSA) was signed into law by former President Obama and became effective on May 11, 2016, amid much fanfare. At the time of its passage, the law was described as the “most significant expansion” of federal law in intellectual property since the Lanham Act in 1946. The DTSA provided a federal cause of action for trade secret misappropriation. In addition, it provided for a specialized seizure remedy, as well as an immunity provision designed to protect employees who might disclose trade secrets when allegedly reporting violations of the law.

The DTSA’s impact over the past year has been limited. Although the DTSA has made it easier for trade secret litigants to establish federal jurisdiction and thus get into federal court, there have been no sweeping changes in trade secret litigation. To date, federal courts do not appear enamored by the extra case load, and nearly all of the federal court decisions have continued to predominantly rely on pre-existing state and federal law and remedies. Despite the widespread publicity, both the seizure remedy and the immunity provision have had extremely minimal application and impact to date. See Bradford K. Newman & Esther Cheng, Federal Trade Secrets Protection: Law Would Create More Problems than It Solves, DAILY J., Apr. 28, 2016.

Creating a Federal Cause of Action
The DTSA creates the first federal civil cause of action and suite of statutory remedies for the misappropriation of trade secrets in the United States and provides a single uniform cause of action for trade secret misappropriation across the states. Prior to its enactment, as a civil matter, trade secret misappropriation claims (as opposed to Computer Fraud and Abuse Act claims pursuant to 18 U.S.C. § 1030) were governed exclusively by state laws. (Although most states have enacted the Uniform Trade Secrets Act (UTSA), there are still two outliers that protect trade secrets under unique state statutes or common law: New York and North Carolina.) Plaintiffs who sued for trade secret misappropriation in different states faced some longstanding and well-understood differences in legal standards and procedural requirements. The DTSA was purportedly intended to create a uniform body of federal trade secret law while establishing jurisdiction for claims brought pursuant to the DTSA in the federal courts.

On its face, however, the DTSA does not pre-empt state law, meaning that a party can file suit under the DTSA in federal court and plead a state law claim arising out of the same facts. In practice, this means that the DTSA’s primary function to date has been to create a path for plaintiffs to litigate what historically were essentially state law trade secret claims in federal court.

The DTSA cause of action is similar to those brought pursuant to the UTSA. The DTSA at 18 U.S.C. § 1836(b)(1) allows a plaintiff to bring a civil action for misappropriation of trade secrets in the United States and provides a single uniform cause of action for trade secret misappropriation across the states.
cret was acquired by improper means; or (b) disclosure or use of the trade secret by a person who used “improper means” to acquire the trade secret or had certain knowledge. Notably, the term “improper means” does not include reverse engineering or independent derivation under section 1836(b)(3)(B)(6).

**Monetary and Injunctive Relief**

Under section 1836(b)(3)(B) of the DTSA, a party can recover injunctive relief, monetary damages, and attorney’s fees. A discussion of injunctive relief follows. (To date, no court has reached the damages stage of a DTSA case, and thus, monetary relief is not addressed in this article.)

Injunctive relief is permitted under section 1836(b)(3)(A)(i) of the DTSA to prevent any actual or threatened misappropriation on terms “the court deems reasonable.” To prevent plaintiffs from pursuing inevitable disclosure claims and claims aimed at restraining employee mobility, section 1836(b)(3)(A)(ii) provides that injunctive relief may only be issued if it does not “prevent a person from entering into an employment relationship,” and if the “conditions placed on such employment” are “based on evidence of threatened misappropriation and not merely on the information the person knows.” In addition, under section 1836(b)(3)(A)(iii), the injunctive relief ordered must not conflict with any applicable state laws. Injunctive relief is also available under section 1836(b)(3)(A)(iv) if affirmative actions are required to protect the trade secret and the court determines it is appropriate. At a high level, experienced practitioners will recognize there is little about this standard that could be deemed novel under the Federal Rules of Civil Procedure or state corollaries.

Since the enactment of the DTSA, federal courts have not hesitated to grant injunctive relief based solely on existing state and federal law that predates the DTSA. Frequently, the analysis focuses on traditional application of the Federal Rules of Civil Procedure’s injunctive relief provision and either ignores the existence of the DTSA claim in the complaint, or analyzes the dual state-law/DTSA basis for a traditional injunction in tandem.

For example, in *Henry Schein, Inc. v. Cook*, No. 16-CV-03166-JST, 2016 WL 3418537 (N.D. Cal. Jun. 22, 2016), the court granted a motion for preliminary injunction after finding, *inter alia*, that Henry Schein, Inc. had established a likelihood of success on its claims of trade secrets misappropriation brought under both the DTSA and California Uniform Trade Secrets Act (“CUTSA”). In making this decision, the court analyzed both the DTSA and CUTSA claims simultaneously.

Similarly, in *Engility Corp. v. Daniels*, No. 16-CV-2473-WJM-MEH, 2016 WL 7034976, at *10 (D. Colo. Dec. 2, 2016), the Colorado district court granted a preliminary injunction under both the DTSA and the Colorado Uniform Trade Secrets Act. Notably, as part of the preliminary injunction in *Engility Corp.*, the court enjoined Daniels and his new company from competing for certain business for a period of one year. The court noted that, although the DTSA prohibits injunctions that “conflict with an applicable State law prohibiting restraints on the practice of a lawful profession, trade, or business,” such as Colorado’s statutory restrictions on noncompete provisions, the injunction was necessary to prevent Daniels and his new company from taking advantage of trade secrets in their possession and therefore fell within an exception to Colorado’s statutory noncompete restrictions. The court did not separately analyze the propriety of the injunction under the Colorado Uniform Trade Secrets Act, merely concluding that, despite its less specific provision regarding injunctive relief, it “probably has the same sorts of restrictions as the DTSA.”

In *Panera, LLC v. Nettles*, No. 4:16-CV-1181-JAR, 2016 WL 4124414, at *4 (E.D. Mo. Aug. 3, 2016), Panera LLC, a restaurant chain, moved for a temporary restraining order against Michael Nettles, a former employee, and his new employer, Papa John’s International, Inc., in the Eastern District of Missouri under both the Missouri Uniform Trade Secrets Act (MUTSA) and the DTSA. The court granted the motion based on the MUTSA claim and declined to analyze the DTSA claim in the context of a footnote, which pointed out that, “although the Court’s analysis has focused on Panera’s Missouri trade secrets claim, an analysis under the Defend Trade Secrets Act would likely reach a similar conclusion.”

Finally, in *Earthbound Corp. v. Mi-Tek USA, Inc.*, C16-1150 RSM, 2016 WL 4418013, at *11 (W.D. Wash. Aug. 19, 2016), a Washington district court also granted a temporary restraining order under both Washington state law and the DTSA based on strong circumstantial evidence of defendant’s misappropriation of confidential and trade secret information about Earthbound’s current and prospective customers, pending projects, bids, pricing, product design, and other elements of its business, which would lead to irreparable harm if not enjoined.

The takeaway in the year following the DTSA’s enactment is that, although the DTSA provides a new basis for federal court jurisdiction, absent extraordinary circumstances, practitioners should expect federal judges to analyze injunctive requests largely according to traditional notions of what is required for such relief.

**Ex Parte Civil Seizures**

One of the most widely publicized features of the DTSA is section 1836(b)(3)(d), which permits trade secrets misappropriation plaintiffs to request, on an *ex parte* basis, seizure of the alleged trade secrets before giving any notice to the defendant. Specifically, this provision provides at section 1836(b)(2)(A)(i) that “only in extraordinary circumstances” may the court issue an order “providing for the seizure of property necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action.” To order an *ex parte* seizure, the court must find under section 1836(b)(2)(A)(ii)–(VIII) that: (1) the plaintiff is likely to succeed on the merits; and (2) if notice were provided, the defendant would likely “destroy, move, hide, or otherwise make such matter inaccessible.” The court must then find under section 1836(b)(2)(A)(ii)(III) that the harm in denying the *ex parte* application “out-
weighs the harm to the legitimate interests of the person against whom seizure would be ordered” and “substantially outweighs the harm to any third parties who may be harmed by such seizure.” To avail themselves of this relief, applicants cannot have publicized the requested seizure under section 1836(b)(2)(A)(ii)(VIII).

Federal Courts Are Extremely Hesitant to Grant a Request for the Seizure Remedy

On a nationwide basis, federal courts generally have limited relief under the DTSA to what was already available under the Federal Rules of Civil Procedure and developed state law. For example, in OOO Brunswick Rail Mgmt. v. Sultanov, No. 5:17-cv-00017, 2017 WL 67119, *2–3 (N.D. Cal., Jan. 6, 2017), the court declined to issue a seizure order against Sultanov, a former employee accused of trade secret misappropriation, to seize the company-issued laptop and mobile phone in his possession, despite finding that the plaintiff had satisfied the requirements for a temporary restraining order (i.e., a likelihood of success on the merits of its trade secret claims and irreparable harm in the absence of injunctive relief). The court cited the DTSA’s requirement that seizure orders may be issued only if other forms of equitable relief would be inadequate. It then found that, in this case, such a remedy was “unnecessary” because the court would order Sultanov to deliver the devices to the court at the time of the hearing without accessing or modifying them in the interim.

Similarly, in Magnesita Refractories Co. v. Mishra, 2017 WL 365619 (N.D. Ind. Jan. 25, 2017), the court noted that the DTSA’s seizure provision did not apply because the existing relief, an ex parte temporary restraining order authorizing the seizure of the defendant’s personal laptop computer, was sufficient. The court had ordered the seizure under the traditional temporary restraining order provision in Federal Rule of Civil Procedure 65 after it was shown that there was a “strong likelihood that [Mishra, the former employee] was conspiring to steal [the employer’s] trade secrets contained in the laptop.” The court rejected Mishra’s argument that he was denied the due process provided under DTSA’s seizure provision and denied his motion to vacate the temporary restraining order.

As of the publication of this article, a federal court has granted a request for the seizure remedy in a published decision only in a single, extraordinary circumstance. In Mission Capital Advisors, LLC v. Romaka, No. 16-civ-5878 (S.D.N.Y. July 29, 2016), the District Court for the Southern District of New York ordered a seizure against a defendant, Romaka, only after the defendant first violated a temporary restraining order. Romaka was a former employee of a commercial real estate company and had downloaded contact lists from his former employer without authorization. He then falsely represented that he had deleted this data. In reality, Romaka simply changed the file names and failed to comply with the existing temporary restraining order. As a result, the court granted an order allowing for the seizure of the contact lists, but because only the customer lists had been described with sufficient particularity, the court denied such a request for all other confidential information.

The Future Impact of the Seizure Provision

The early headline from a nationwide review of the initial DTSA cases is an emerging trend by federal courts to look warily on requests to issue DTSA seizure remedies in routine cases where traditional remedies would suffice. Courts are giving great deference to the statutory phrase “extraordinary circumstances” and refraining from finding as much in most cases, despite allegations typically included in the complaint to the contrary.

Should courts become more inclined to grant the seizure order provided under the DTSA, this remedy would prove effective for trade secret owners who seek to immediately enjoin trade secret misappropriators in the most extreme cases from using and disclosing their trade secrets or, for example, from fleeing the country. On the other hand, the seizure provision may also subject over-eager plaintiffs to substantial damages. In addition, although the seizure provision contains a long list of substantive requirements, an emphasis on confidentiality, and procedural safeguards, until the federal trial and appellate courts provide further guidance in the form of published decisions, there is certainly potential for this provision of the DTSA to lead to exploitive tactics, particularly by plaintiffs bringing misappropriation claims based on anticompetitive motives. This scenario could lead to the “potential for abuse of this provision by ‘trade secret trolls’ and larger companies seeking to use the DTSA for competitive advantage against smaller players.” See Bradford K. Newman & Esther Cheng, Federal Trade Secrets Protection: Law Would Create More Problems than It Solves, DAILY J., Apr. 28, 2016. It might also lead to the seizure of company trade secrets by competitors who never should have had access rights to those secrets in the first place. Fortunately, as noted, courts seem to favor a conservative approach, faithful to the statutory text of the seizure provision, signaling the bench’s acknowledgement that it will indeed take “extraordinary circumstances” not found in the commonplace to-and-fro of trade secret litigation.

The Employee Immunity Provision

Another notable provision of the DTSA is its public policy immunity provision at 18 U.S.C. § 1833(b), which offers immunity from liability for the confidential disclosure of a trade secret to a government official or an attorney in order to report a violation of the law. The immunity provision at section 1833(b)(1) protects individual employees from civil or criminal liability for the disclosure of a trade secret that: (a) is made “in confidence to a federal, state, or local government official, either directly or indirectly, or to an attorney” and solely for “the purpose of reporting or investigating a suspected violation of law”; or (b) is made in a complaint or document “filed in a lawsuit or other proceeding” so long as the filing is made under seal. This provision also allows for the use of trade secret information in an anti-retaliation lawsuit. Specifically, if an employee files a lawsuit for retaliation by the employer for “reporting a suspected
violation of law,” then the employee is permitted under section 1833(b)(2) to disclose the trade secret to his or her attorney and use the trade secret information in the court proceeding so long as the trade secrets are filed under seal and not disclosed, except pursuant to a court order.

Under the immunity provision at section 1833(b)(3)(A), an affirmative defense is placed on employers to provide notice of the provision in “any contract or agreement with an employee that governs the use of a trade secret or other confidential information.” An employer can also comply with a notice requirement under section 1833(b)(3)(B) by providing a “cross-reference” to a policy given to the relevant employees. The cross-reference can be an amendment to the contract, which informs the employee of the existence of the immunity provision and “sets forth the employer’s reporting policy for a suspected violation of law.” Failure to comply with the notice requirement prevents an employer from recovering exemplary damages or attorney’s fees in an action against the employee under the DTSA.

No court has so far sanctioned an employee’s actions under the DTSA’s immunity provision; thus, this provision has had minimal impact. Bradford K. Newman, Protecting Intellectual Property Law in the Age of Employee Mobility (American Law Media 2014); 2017 updates at §12-7. In Unum Grp. v. Loftus, No. 4:16-CV-40154-TSH, 2016 WL 7115967 (D. Mass. Dec. 6, 2016), a Massachusetts federal court considered and rejected the argument of Loftus, a former employee of Unum Group, based on the DTSA immunity provision, that Unum Group’s trade secrets misappropriation claims should be dismissed because he took documents containing trade secrets to pursue legal action against the plaintiff for alleged unlawful activities. The court found Loftus’ contentions that his actions were immune under the DTSA unpersuasive because there was nothing in the record to support this affirmative defense at the motion-to-dismiss stage of litigation because discovery had not yet been conducted to determine the significance of the documents taken or their contents, it was not ascertainable from the complaint whether the former employee used, was using, or planned to use those documents for any purpose other than investigating potential violation of law, and no whistleblower suit had been filed. As such, the court found that Loftus’ actions were simply impermissible “self-help discovery” and ordered the return of the documents.

Despite the limited case law to date, the DTSA’s immunity provision likely will be raised repeatedly and thus become the subject of scrutiny by the federal trial courts, given that it is anticipated that employees accused of trade secret theft will continue to invoke this provision as part of their defense. For example, when a company discovers evidence that an employee secretly downloaded trade secrets in connection with exiting the company and files suit under the DTSA, the accused will likely claim that they took the trade secrets for the purpose of providing them to their attorney as part of an “investigation” into suspected violation of some law. Given that this defense is not available under the UTSA, and many states in fact specifically outlaw such “self-help” remedies, hedging against this defense may be one of many reasons why a DTSA plaintiff would also want to bring a claim under the UTSA.

Future Implications of the Defend Trade Secrets Act

At this point, apart from conferring federal jurisdiction over most of the trade secret claims, which would heretofore be governed exclusively by state law, and absent diversity jurisdiction, would be litigated solely in state courts, the DTSA in practice has been something less than a “seismic event.” Federal courts have correctly credited the statutory language that prohibits the seizure remedy absent “extraordinary circumstances,” which, despite being pled in every complaint, is rarely present. In addition, although practitioners should expect to see the employee immunity provision invoked on an increasing basis, it will require unique circumstances to get any traction as well.

Are there any action items in light of the DTSA that companies can employ to strengthen their trade secret protections? The answer is most certainly “yes.” Companies should have qualified counsel review policies and agreements to ensure they contain the language required under the DTSA in order to recoup attorney’s fees in the case where an employee unsuccessfully invokes the DTSA’s immunity provision. Beyond that, companies should continually be assessing and improving how they protect their most valuable confidential employee from insider (employee) threats, including devising and utilizing a high-risk departure program designed to safeguard the most valuable trade secrets upon the departure of key executives.

Finally, given that the DTSA does provide for a seizure remedy, in all cases where a company is faced with a DTSA claim, it is essential to conduct a privileged review of immediate measures to employ in order to minimize the ongoing threat to a third party’s trade secrets (if any) and, thus, decrease the likelihood of a seizure remedy granted.

Bradford K. Newman is the founder and chair of Paul Hastings’ Employee Mobility and Trade Secret Practice. He is the editor of the 2017 edition of Recent Developments in Business and Corporate Litigation and a past chair of the ABA Section of Business Law’s Employment Litigation Subcommittee of the Business and Commercial Litigation Committee.

Jessica Mendelson and MiRi Song are members of the Paul Hastings’ Employee Mobility and Trade Secret Practice.
In this digital age, social media, texts, and a variety of other forms of technology have increasingly become evidence, or sought as evidence, in a wide sundry of litigation. How do you ensure that this evidence comes in at trial? This issue can prove daunting to newer practitioners as well as more seasoned practitioners who may not be as knowledgeable as to how to introduce into evidence e-mails, texts, or Facebook posts. Although it may appear more complicated at first glance, the short answer is simple: authentication. As with all other types of evidence, digital evidence must be authenticated in order to be properly introduced at trial. However, authenticating digital evidence can pose some interesting challenges.

As an initial matter, the proffered evidence must first be determined to be relevant. The test for determining relevancy is Federal Rule of Evidence (FRE) 401, which provides: “Evidence is relevant if: (a) it has any tendency to make a fact more or less probable than it would be without the evidence; and (b) the fact is of consequence in determining the action.” Once the evidence is determined to be relevant, then it must be determined to be authentic.

The authentication standard is the same regardless of whether the evidence is digital or in a more traditional form—that is, FRE 901(a) requires the party proffering the evidence to demonstrate that the evidence is what it is claimed to be. FRE 901(b) sets forth examples of evidence that satisfy the general requirements of FRE 901(a), including, but not limited to, the testimony of a witness with knowledge under FRE 901(b)(1), distinctive characteristics of the item under FRE 901(b)(4), or a comparison by an expert witness under FRE 901(b)(3).

E-mails are now commonly offered as evidence at trial. After first demonstrating that the evidence is relevant pursuant to FRE 401, the attorney proffering this evidence must establish authenticity: Was the e-mail sent to and from the persons as indicated on the e-mail? Here, a witness with personal knowledge may testify as to the e-mail’s authenticity, which typically is the author of the e-mail or a witness who saw the proffered e-mail drafted and/or received by the person the proponent claims drafted/received the e-mail. In addition, if the e-mail has been produced in response to a sufficiently descriptive document request, the production of the e-mail in response may constitute a statement of party-opponent and found to be authenticated under FRE 801(d)(2).

Texts are also becoming increasingly offered as evidence at trial. Typically, evidence of texts is obtained in one of two forms: (1) as screen shots; or (2) as photographs of the text messages. Whether a screen shot or a photograph, it is important that the screen with the text message, the name and/or phone number of the person sending the text message, and the date and time the message was sent are clearly displayed. Text messages can be authenticated by the testimony of a witness with knowledge or by distinctive characteristics of the item, including circumstantial evidence such as the author’s screen name or monikers, customary use of emoji or emoticons, the author’s known phone number, the reference to facts that are specific to the author, or reference to facts that only the author and a small number of other individuals may know.

Social media networks such as Facebook, LinkedIn, and the like are now ubiquitous; consequently, social media posts have increasingly become evidence at trial. However, authenticating a social media post generally is more difficult than an e-mail or a text. For example, it is insufficient to simply show that a post was made on a particular person’s webpage; it is generally too easy to create a Facebook page or the like under...
someone else’s name. In addition, an individual could have gained access to someone else’s social media account. To properly introduce evidence of a social media post at trial, you must first have a printout (or download, if a video) of the webpage that depicts the social media post you seek to introduce as evidence, and the person who printed or downloaded the post must testify that the printouts accurately reflected what was on his or her screen when it was printed or downloaded.

Once that is established, the social media post must be authenticated. This can be done in several ways. Direct witness testimony can be obtained by the purported creator of the post, from someone who saw the post being created, and/or from someone who communicated with the alleged creator of the post through that particular social media network. Testimony can be obtained from the social media network to establish that the alleged creator of the post had exclusive access to the originating computer and the social media account. The subscriber report can also be subpoenaed from the social media network, which can identify all posts made and received as well as any comments, “likes,” “shares,” photographs, etc. As with e-mails and texts, circumstantial evidence may also be used for authentication pursuant to FRE 901(b)(4) if, for example, the post contains references or information relating to family members, a significant other, or co-workers; the writing style of the posts or comments is in the same style (i.e., slang, abbreviations, nicknames, and/or use of emoji/emoticons) the purported author uses; or there are private details about the author’s life or details that are not widely known that are indicated in the post. Finally, do not overlook the option of having the author of the social media post authenticate the post and testify regarding the post in his or her deposition.

In sum, authentication is key to getting digital evidence such as e-mails, texts, and social media posts admitted into evidence, but proper authentication can be a significant hurdle, and this often is a fact-driven issue that will vary from case-to-case.

Michaela Battista Sozio is the managing partner of Tressler LLP’s Los Angeles office. She is an experienced litigator with more than 20 years of experience in the courtroom defending corporate and individual clients in a variety of matters.
Under Delaware law, as under federal law, a corporate stockholder may assert a cause of action derivatively on behalf of a corporation for harms caused to the corporation by its directors and officers. However, a stockholder’s right to bring such a derivative action conflicts with a board of directors’ right to manage the business and affairs of a corporation. Therefore, a stockholder in a Delaware corporation who wishes to bring suit derivatively on behalf of a corporation must either make a demand on the corporation’s board of directors to bring the suit or be prepared to explain in the complaint why such a demand would be futile. Under Delaware Court of Chancery Rule 23.1, a derivative complaint must allege “with particularity” the plaintiff’s efforts to obtain the desired action from the board or must allege, also “with particularity,” “the reasons for the plaintiff’s failure to obtain the action or for not making the effort.” In most cases, the complaint sets forth the plaintiff’s reasons “for not making the effort,” usually alleging that demand on the board would be futile because a majority of the board members were either interested in the challenged transaction or lacked the required independence from an interested party. A complaint that fails to allege such “demand futility” with particularity will be dismissed under Rule 23.1.

A director who participates on both sides of the challenged transaction, or who obtains a benefit not shared with all stockholders, is interested in the transaction. A director who is financially “beholden to” an interested person, or who has a relationship with an interested person that would affect the director’s ability to exercise independent judgment, lacks independence. Demand on the board is excused, and a stockholder may bring suit derivatively, when a majority of the board members are either interested or lack independence.

Many Delaware cases have focused on the types of relationships that render directors not independent.

In a recent case, Sandys v. Pincus, 2016 Del. LEXIS 627 (Del. Dec. 5, 2016), the Delaware Supreme Court reversed the Delaware Court of Chancery’s dismissal of a derivative suit based on failure to plead demand futility with particularity. The Court of Chancery found that the facts alleged in the complaint were insufficient to show that a majority of the members of the corporation’s board were either interested in the challenged transaction or lacked independence from an interested person. Four of the five members of the Delaware Supreme Court, sitting en banc, disagreed. The majority opinion, authored by Chief Justice Leo E. Strine, Jr., further defines the types of relationships that can render directors not independent.

In addition to discussing the Delaware Supreme Court’s opinion in Sandys v. Pincus, this article will refer to off-the-cuff remarks made by Chief Justice Strine at the Securities Regulation Institute in Coronado, California, on January 23, 2017, regarding Sandys v. Pincus and, more generally, the problems of director independence under Delaware law.

Summary of Facts

The complaint in Sandys v. Pincus alleged that several top managers and directors of Zynga, Inc. traded on inside information, selling 20.3 million shares of Zynga stock...
at $12 per share, for a total of $236.7 million, shortly before an earnings announcement disclosed information that caused the market price to drop 9.6 percent to $8.52 per share. The complaint also alleged that the insiders were aware at the time of the sale of additional negative information that, when disclosed three months later, caused Zynga’s market price to drop to $3.18 per share, for a total decline of 73.5 percent from the $12 sale price. The complaint asserted claims for breach of fiduciary duty against the insiders who participated in the sale and the directors who approved the sale.

The defendants included Mark Pincus, who was the former CEO, chairman, and controlling stockholder of Zynga, holding 61 percent of the company’s voting power. At the time the complaint was filed, the Zynga board of directors was composed of nine directors, two of whom, Pincus and defendant Reid Hoffman, had participated in the challenged transaction. Another, Don Mattrick, was Zynga’s CEO.

Based on the allegations in the complaint, the Court of Chancery found that at least five of Zynga’s directors—a majority of the board—were not interested in the transaction and were independent of Pincus. The Delaware Supreme Court disagreed as to the independence of three of those five: Ellen Simonoff, William Gordon, and John Doerr. The court found that, in addition to Pincus and Hoffman, who were interested in the transaction, Mattrick (the CEO), was not independent because Pincus, as the controlling stockholder, controlled Mattrick’s livelihood. Therefore, a majority of six of the nine board members were either interested (Pincus and Hoffman) or lacked independence from Pincus (Mattrick, Simonoff, Gordon, and Doerr), demand was excused as futile, and the complaint should not have been dismissed.

**Director Simonoff Was Not Independent Because of Co-Ownership of an Airplane With Pincus**

The complaint alleged that director Ellen Simonoff, together with her husband, had “an existing business relationship with defendant Pincus as co-owners of a private airplane.” The Delaware Supreme Court found that “the most likely inference” from that alleged fact was that there was “an extremely close, personal bond between Pincus and Simonoff, and between their families.” The court accepted the plaintiff’s argument that “owning an airplane together is not a common thing” and that such co-ownership “suggests that the Pincus and Simonoff families are extremely close to each other and are among each other’s most important and intimate friends.” The court determined that co-ownership of an airplane “is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human’s ability to exercise impartial judgment.” The court maintained that the elevated pleading standard in the demand excusal context—“with particularity”—“does not require a plaintiff to plead a detailed calendar of social interaction to prove that directors have a very substantial personal relationship rendering them unable to act independently of each other.” The court thus concluded that the alleged facts were sufficient to support an inference that Simonoff was not independent of Pincus.

**Directors Gordon And Doerr Were Not Independent Because of “Mutually Beneficial Business Relations” With Pincus**

The complaint alleged that two other directors, William Gordon and John Doerr, were partners at Kleiner Perkins Caufield & Byers, an investment firm that controlled 9.2 percent of Zynga’s equity. Kleiner Perkins also invested in a company cofounded by Pincus’s wife. In addition, Kleiner Perkins and defendant Hoffman (who participated in the challenged transaction along with Pincus) coinvested in another company, Shopkick, Inc., and Hoffman served on Shopkick’s board with another Kleiner Perkins partner. The court accepted the plaintiff’s argument that “Gordon and Doerr have a mutually beneficial network of ongoing business relations with Pincus and Hoffman that they are not likely to risk by causing Zynga to sue them,” and rejected the defendants’ argument that “the relationships among these directors flowed all in one direction and that it is Pincus who is likely beholden to Gordon, Doerr, and Kleiner Perkins for financing.” The court determined that, “precisely because of the importance of a mutually beneficial ongoing business relationship, it is reasonable to expect that sort of relationship might have a material effect on the parties’ ability to act adversely toward each other.”

**Gordon and Doerr Were Not Considered Independent under NASDAQ Listing Rules**

The court also emphasized the fact that Zynga did not disclose why its board made this determination. Although the Delaware standard for director independence “does not perfectly marry with the standards of the stock exchange in all cases,” the NASDAQ criteria “are relevant under Delaware law and likely influenced by our law.” The court listed the relationships that automatically preclude a finding of independence under the NASDAQ rules, concluding that the “bottom line” is that “a director is not independent if she has a ‘relationship which, in the opinion of the Company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.’” The court determined that Delaware law “is based on the sensible intuition that deference ought to be given to the business judgment of directors whose interests are aligned with those of the company’s stockholders.” Thus, when a board of directors has determined that one of its members has a relationship that would interfere with her judgment in carrying out her responsibilities generally—even more so in the “high-salience context” of Rule 23.1, where the determination of independence “can short-circuit a merits determination of a fiduciary duty claim”—courts should exercise an “understandable skepticism.”

Thus, given their alleged relationship with Pincus and Hoffman and the fact that
they were not identified as independent under the NASDAQ rules, the Delaware Supreme Court concluded that Gordon and Doerr lacked independence for purposes of demand excusal.

**Plaintiff Failed To Investigate the Directors’ Independence before Filing Suit**

A recurring theme in the *Sandys v. Pincus* opinion is the plaintiff’s failure to conduct an adequate pre-suit investigation into the independence of the Zynga board of directors from the company’s controlling stockholder (Pincus). Although the plaintiff did exercise his right as a stockholder to seek books and records from the company regarding the challenged transaction, he did not seek books and records “bearing on the independence of the board.” The court determined that the “tools at hand” for drafting a complaint include not only traditional books-and-records demands, but “the tool provided by the company whose name has become a verb—or another internet search engine.” If the plaintiff had “Googled” the defendants, “he likely would have discovered more information about Simonoff’s relationship with Pincus.” The court noted that, although “an internet search will only have utility if it generates information of a reliable nature,” the court “can take judicial notice that internet searches can generate articles in reputable newspapers and journals, postings on official company websites, and information on university websites that can be the source of reliable information.” The court determined that the plaintiff’s “lack of diligence put the Court of Chancery in a compromised and unfair position . . . and the plaintiff is fortunate that his failure to do a pre-suit investigation has not resulted in dismissal.”

**Justice Valihura’s Dissent Emphasizes the Presumption of Director Independence**

In an unusual move, Justice Karen Valihura lodged a written dissent to the court’s ruling. She disagreed with the majority on the independence of directors Simonoff, Gordon, and Doerr. In her view, the plaintiff failed to allege facts showing the materiality of Simonoff’s co-ownership of the airplane or of Gordon’s and Doerr’s business relationships with Pincus and Hoffman. She emphasized that, in the demand-futility context, directors are presumed independent and that plaintiffs have the burden to plead facts “with particularity” showing that the alleged relationships were of a “bias-producing” nature.

As to Simonoff, she noted that the complaint alleged only a business relationship between Simonoffs and Pincus and that the only reference to a “close friendship” appeared in an unverified brief that could not be considered on a motion to dismiss based on the pleadings. Quoting *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del., 2004), she determined that, “a reasonable inference cannot be made that a particular friendship raises a reasonable doubt ‘without specific factual allegations to support such a conclusion.’”

In *Beam*, the Delaware Supreme Court affirmed the Court of Chancery’s dismissal of a complaint that contained allegations that a director was a “longtime personal friend” or had a “longstanding personal relationship” with the controlling stockholder, Martha Stewart.

As to Gordon and Doerr, and Zynga’s failure to identify them as independent directors under NASDAQ rules, Justice Valihura reasoned that it is “not difficult to come up with a scenario where a director might be deemed ‘non-independent’ under the NASDAQ rules, or NYSE rules, yet deemed independent for demand futility purposes,” for example, if the designation were due to a relationship with the corporation or an executive other than the controlling stockholder. Given the plaintiff’s pleading burden and failure to explain why Gordon and Doerr were identified as not independent for NASDAQ purposes, Justice Valihura did not believe that the plaintiff was entitled to an inference that Gordon and Doerr were not independent for demand-futility purposes.

Finally, Justice Valihura noted that, “internet searches likely are not, in most cases, an adequate substitute for [books and records] demands made pursuant to 8 Del. C. § 220,” and that the majority “never identifies what information likely would have been discovered.” She noted that, on motions to dismiss, courts are “stuck with the limited factual allegations made by the plaintiff,” and that courts may not take judicial notice of facts outside the pleading unless they are not “subject to reasonable dispute,” and the parties are “given prior notice and an opportunity to challenge judicial notice of that fact.”

**Chief Justice Strine’s “Off the Cuff” Comments**

On January 23, 2017, Chief Justice Strine, the author of the *Sandys v. Pincus* opinion, took part in a “conversation” at the Securities Regulation Institute in Coronado, California, where he discussed issues raised by the opinion along with other issues of director independence.

The Chief Justice stated the view that some personal relationships are akin to family relationships and urged courts and boards of directors to “dig in” and not just “check the box” on exchange independence standards. He distinguished cases in which directors serve on other boards together or attend weddings (as in the Delaware Supreme Court’s 2004 *Stewart* case), which may signal nothing more than a social or economic circle or peer group. Rather, he asked, who owns a plane together? Co-owning an airplane or a boat is “a big deal.” The Chief Justice stressed that boards should give advance consideration to the likelihood of litigation—it happens to every public company—and think, “who are our really independent directors”—the individuals who could be trusted to make a decision about whether to sue a fellow board member.

In addition, the Chief Justice said that, when a deal is anticipated, it is important for a board to switch from routine, “short-form” minutes to “long-form” minutes, and that the board should flag the change and state why it is being made. Boards that launch without explanation into long-form minutes do not look credible because the minutes are “lumpy”—too much on x and nothing on y. That is why short-form, but thoughtful, “contextual” minutes are best.
and should be maintained in most situations. When there is a reason to start including more detail, the board should state so and state why. According to the Los Angeles-San Francisco Daily Journal, the Chief Justice suggested that it might even be wise to record key meetings to ensure that events are recalled accurately. “I’d much rather have a tape recording of the meeting . . . than to have somebody doing bad minutes or taking bad notes,” Strine said.

According to the Daily Journal, the Chief Justice also urged corporate attorneys to step in while boards are formed to head off director conflicts that can be raised in derivative lawsuits. He said that attorneys must be willing to probe deeply into relationships among directors through their own external research and direct questioning of potential board members. “Uncomfortable questions need to be asked,” Strine said.

**Key Takeaways**

**Beware of “Mutually Beneficial Business Relations” Between Directors and Controlling Stockholders**

Traditionally, a director lacks independence from an interested person if the director is “beholden to” the interested person. Under Sandys v. Pincus, the reverse may be true; a director may lack independence because the interested person is beholden to the director. The allegation that the interested person has an obligation to the director can lead to an inference of “mutually beneficial business relations” such that the director is deemed unable to exercise independent judgment and is disabled from considering a presuit demand for board action against the interested person. The key takeaway is that corporate counsel must consider obligations flowing in both directions, and not just obligations that otherwise independent directors owe to controlling stockholders.

**Beware of Co-Ownership of Significant Assets Between Directors and Controlling Stockholders**

Under Sandys v. Pincus, co-ownership of a significant asset, such as a private airplane or a boat, whether for a business purpose or otherwise, can lead to an inference that a close personal relationship akin to family exists, and that a director in such a relationship is not independent for purposes of demand excusal. The key takeaway is that corporate counsel should inquire about and investigate the existence of co-owned assets in determining whether a board of directors has a majority of truly independent directors.

**Directors Who Are Not Independent under Exchange Rules Are Unlikely To Be Found Independent for Demand-Excusal Purposes**

The Delaware Supreme Court did not go so far as to say that a director who is not independent under NASDAQ or other exchange rules is per se not independent for demand-excusal purposes, but Sandys v. Pincus strongly suggests that it is unwise to assume otherwise. Under Sandys, a company’s board should consider disclosing the reasons for its determination that a director is not independent under exchange rules, and should be prepared to explain why such a director should be considered independent for demand-excusal purposes. Although plaintiffs have the burden of pleading particular facts that create a reasonable doubt regarding independence, the mere fact that a director is not independent under exchange rules may be sufficient to meet that burden in future cases.

**Plaintiffs’ Lawyers Should Seek Books and Records Related To Board Independence**

In Sandys, the plaintiff conducted a presuit investigation by seeking corporate books and records related to the challenged transaction. At that time, a majority of the board members had participated in the challenged transaction, so a majority of the board was interested and unable to consider a demand to sue themselves. The plaintiff, assuming that demand was futile under those circumstances, did not seek books and records regarding board independence. However, the composition of the board changed before the complaint was filed so that only two of the nine board members who would have considered a demand at that time—the so-called demand board—had participated in the transaction. As a result, it was a “close call” whether the board was disabled, and the plaintiff was “fortunate” that the dismissal of his complaint under Rule 23.1 was reversed on appeal. The key takeaway for plaintiffs’ lawyers is that they should always seek information about board independence when demanding books and records in prederivative-suit investigations.

**Plaintiffs’ Lawyers Should Always “Google” the Members of the Demand Board**

In Sandys, the court scolded the plaintiff for his “cursory” presuit investigation into board independence, insisting that the plaintiff “likely would have discovered more information” if he had conducted an Internet search of reliable sources. The court determined that it could “take judicial notice” that such resources “can be the source of reliable information.” Many derivative and class-action complaints over the years have quoted newspaper and magazine articles in alleging corporate wrongdoing. The Delaware Supreme Court suggests in Sandys that plaintiffs can also rely on reputable Internet sources in pleading demand futility.

Mr. McMillan is a senior attorney in the Wilmington, Delaware, office of Pepper Hamilton LLP.
Ten Rules Every Lawyer—and Client—Should Know about Taxes on Legal Settlements

By Robert W. Wood

Lawyers and clients resolve disputes all the time, usually with an exchange of money and a release. Almost any time money changes hands, there are tax issues for both sides, coming up in a surprising number of ways. Perhaps your car was rear-ended while stopped at a red light, your contractor did shoddy work on your condo, you were unfairly fired, or someone did you wrong and, as a result, you are collecting a settlement payment or judgment. As it relates to taxes, the first question in any of these situations is whether the settlement payment or judgment is taxable income, and the answer usually is “yes.” The tax treatment in these situations can vary enormously, however, depending on how you were damaged, how the case was resolved, how payment was made, how IRS Forms 1099 were issued, and other variables. Here are 10 rules lawyers and clients should know about the taxation of settlements.

1. Settlements and Judgments Are Taxed the Same
   The same tax rules apply whether you are paid to settle a case (even if your dispute only reached the letter-writing phase) or win a judgment. Despite this similarity, however, you will almost always have more flexibility to reduce taxes if a case settles rather than goes to judgment. If you are audited, you must show what the case was about, and what you were seeking in your claims. Consider the settlement agreement, the complaint, how payments were made to resolve the case, IRS Forms 1099 (or W-2), etc. You can influence how your recovery is taxed by how you deal with these issues.

2. Taxes Depend on the “Origin of the Claim”
   Settlements and judgments are taxed according to the matter for which the plaintiff was seeking recovery (the origin of the claim). If you are suing a competing business for lost profits, a settlement or judgment will be considered lost profits taxed as ordinary income. If you are laid off at work and sue for discrimination seeking wages and severance, you will be taxed on your settlement or judgment as having received wages.
   In fact, your former employer probably will withhold income and employment taxes on all (or part of) your settlement, even if you have not worked there for years. On the other hand, if you sue for damage to your condo by a negligent building contractor, your damages usually will not be considered income. Instead, the recovery may be treated as a reduction in the purchase price of the condo. That favorable rule means you might have no tax to pay on the money you collect. These rules are full of exceptions and nuances, however, so be careful. Perhaps the biggest exception of all applies to recoveries for personal physical injuries (see rule 3).

3. Recoveries for Personal Physical Injuries and Physical Sickness Are Tax-Free
   This is a really important rule that causes almost unending confusion with lawyers and their clients. If you sue for personal physical injuries resulting from, for example, a slip and fall or car accident, your compensatory damages should be tax-free. That may seem odd if, because you could not work after your injuries, you are seeking lost wages. However, a specific section of the tax code—section 104—shields damages for personal physical injuries and physical sickness.
   Note the “physical” requirement. Before 1996, “personal” injury damages included emotional distress, defamation, and many other legal injuries and were tax-free. Since 1996, however, your injury also must be
“physical” to give rise to tax-free money. Unfortunately, neither the IRS nor Congress has made clear what that means. The IRS has determined generally that you must have visible harm (cuts or bruises) for your injuries to be “physical.” This observable bodily harm standard generally means that, if you sue for intentional infliction of emotional distress, your recovery is taxed.

Likewise, if you sue your employer for sexual harassment involving rude comments or even fondling, that also is not physical enough for the IRS. Some courts have disagreed, however, and the U.S. Tax Court in particular has allowed some employment lawsuits complete or partial tax-free treatment where the employee developed a physical sickness from the employer’s conduct or where a pre-existing illness was exacerbated. Taxpayers routinely argue in U.S. Tax Court that their damages are sufficiently physical to be tax-free, and although standards are getting a little easier, the IRS usually wins these cases. In many cases a tax-savvy settlement agreement could have improved the plaintiff’s tax chances.

4. Symptoms of Emotional Distress Are Not “Physical”

Tax law draws a distinction between money you receive for physical symptoms of emotional distress (like headaches and stomachaches) and physical injuries or sickness. Here again, these lines are not clear. For example, if in settling an employment dispute, suppose that you receive an extra $50,000 because your employer gave you an ulcer. Is an ulcer considered “physical” or is it merely a symptom of your emotional distress?

Many plaintiffs end up taking aggressive positions on their tax returns by claiming that damages of this nature are tax-free. Yet that can be a losing battle if the defendant issues an IRS Form 1099 for the entire settlement. That means it can behave you to try to come to an agreement with the defendant about the tax issues, and there is nothing improper about doing so. There are wide variations in tax reporting and multiple players are often involved in litigation (e.g., the parties, their insurance companies, and their attorneys); thus, neglecting to nail all this down in the settlement agreement can be foolish. You may have to pay for outside tax experts, but you will almost always save considerable money later by spending a little at this critical moment. Otherwise, you might end up surprised with Forms 1099 you receive the year after your case settles. At that point, you will not have a choice about reporting the payments on your tax return.

5. Medical Expenses Are Tax-Free

Even if your injuries are purely emotional, payments for medical expenses are tax-free, and what constitutes “medical expenses” is surprisingly liberal. For example, payments to a psychiatrist or counselor qualify, as do payments to a chiropractor or physical therapist. Many nontraditional treatments count as well.

However, if you have previously deducted the medical expenses and are reimbursed when your suit settles in a subsequent year, you may have to pay tax on them. Blame the “tax benefit” rule, which provides that, if you previously claimed a deduction for an amount that produced a tax benefit to you (meaning it reduced the amount of tax you paid), you must pay tax on that amount if you recover it in a subsequent year. The opposite is also true. If you deducted an amount in a previous year, and that deduction produced no tax benefit to you, then you can exclude the recovery of that amount in a later year from your gross income.

6. Allocating Damages Can Save Taxes

Most legal disputes involve multiple issues, but even if your dispute relates to one course of conduct, there is a good chance the total settlement amount will involve multiple categories of damages. It usually is best for the plaintiff and defendant to agree on what is paid and its tax treatment. Such agreements are not binding on the IRS or the courts in later tax disputes, but they are rarely ignored. As a practical matter, what the parties put down in the agreement often is followed.

For all of these reasons, it is more realistic—and more likely to be respected by the IRS and other taxing authorities—if you divide up the total and allocate it across multiple categories. If you are settling an employment suit, there might be some wages (with withholding of taxes and reported on a Form W-2); some nonwage emotional distress damages (taxable, but not wages, so reported on a Form 1099); some reimbursed business expenses (usually nontaxable, unless the employee had deducted them); some pension or fringe benefit payments (usually nontaxable); and so on. There may even be some payment allocable to personal physical injuries or physical sickness (nontaxable, so no Form 1099), although this subject is controversial (see rules 3 and 4).

7. Look for Capital Gain Instead of Ordinary Income

Outside the realm of suits for physical injuries or physical sickness, just about everything is income; however, that does not answer the question of how it will be taxed. If your suit is about damage to your house or your factory, the resulting settlement may be treated as capital gain. Long-term capital gain is taxed at a lower rate (15 percent or 20 percent, plus the 3.8% Obamacare tax, not 39.6 percent) and is therefore much better than ordinary income.

Apart from the tax-rate preference, your tax basis may be relevant as well. This generally is your original purchase price, increased by any improvements you have made and decreased by depreciation, if any. In some cases, your settlement may be treated as a recovery of basis, not income.

A good example is harm to a capital asset, such as your house or your factory. If the defendant damaged it and you collect damages, you may be able to simply reduce your basis rather than report gain. Some settlements are treated like sales; therefore, again, you may be able to claim your basis. In fact, there are many circumstances in which the ordinary income versus capital gain distinction can be raised, so be sensitive to it. For example, some patent cases can produce capital gain, not ordinary income. The tax rate spread can be nearly 20 percent.
8. Attorney’s Fees Can Be a Trap

Whether you pay your attorney hourly or on a contingent-fee basis, legal fees will impact your net recovery and your taxes. If you are the plaintiff and use a contingent-fee lawyer, you usually will be treated (for tax purposes) as receiving 100 percent of the money recovered by you and your attorney. This is so even if the defendant pays your lawyer the contingent fee directly.

If your case is fully nontaxable (e.g., an auto accident in which you are physically injured), that should cause no tax problems. Yet if your recovery is taxable, the type of deduction you can claim for the legal fees can vary materially. This trap occurs frequently. Suppose you settle a suit for intentional infliction of emotional distress against your neighbor for $100,000, and your lawyer keeps 40 percent, or $40,000.

You might think that you would have $60,000 of income. Instead, you will have $100,000 of income, followed by a $40,000 miscellaneous itemized deduction. That means you will be subject to numerous limitations that can whittle your deduction down to nothing. For alternative minimum tax (AMT) purposes, you get no tax deduction for the fees. That is why many clients say they are paying tax on money (the attorney’s fees) they never received.

Notably, not all attorney’s fees face such harsh tax treatment. If the lawsuit concerns the plaintiff’s trade or business, the legal fees are a business expense. Those legal fees are “above the line” (a better deduction). Moreover, if your case involves claims against your employer, or involves certain whistleblower claims, there is an above-the-line deduction for legal fees. That means you deduct those legal fees before you reach the adjusted gross income (AGI) line on the front of your 1040. An above-the-line deduction prevents the problems related to miscellaneous itemized deductions taken after your AGI has been calculated. Outside of employment and certain whistleblower claims or claims involving your trade or business, however, be careful: there are sometimes ways of circumventing these attorney’s fees rules, but you need sophisticated tax help before your case settles to do it.

9. Punitive Damages and Interest Are Always Taxable

Punitive damages and interest are always taxable, even if your injuries are 100 percent physical. Suppose you are injured in a car crash and receive $50,000 in compensatory damages and $5 million in punitive damages. The $50,000 is tax-free, but the $5 million is fully taxable. Moreover, you might have trouble deducting your attorney’s fees (see rule 8).

The same occurs with interest. You might receive a tax-free settlement or judgment, but prejudgment or postjudgment interest is always taxable. As with punitive damages, taxable interest can produce attorney’s fees deduction problems. These rules can make it more attractive (from a tax viewpoint) to settle your case rather than have it go to judgment.

Return to the situation above, in which you receive $50,000 in compensatory (tax-free) damages, plus $5 million in punitive damages. Can you settle instead for $2 million that is all tax-free? It depends (among other things) on whether the judgment is final or on appeal. It also depends on what issues are up on appeal. The facts and procedural posture of your case are important. In some cases, you can make it much better off, from a tax viewpoint, taking less money.

10. It Pays to Consider the Defense

Plaintiffs generally are much more worried about tax planning than defendants. Nevertheless, consider the defendant’s perspective as well. A defendant paying a settlement or judgment will always want to deduct it. If the defendant is engaged in a trade or business, doing so rarely will be questioned, given that litigation is a cost of doing business. Even punitive damages are tax deductible by businesses. Only certain government fines cannot be deducted, and even then defendants can sometimes find a way if the fine is in some way compensatory.

Despite these broad deduction rules for businesses, not everyone is so lucky. If the suit is related to investments, the deduction could be restricted to only investment income or face other limitations. If the suit is purely personal, the defendant may get no deduction at all. In some cases, that can extend to attorney’s fees as well.

Defendants can also run up against questions about whether an amount can be immediately deducted or must be capitalized. For example, if a buyer and seller of real estate are embroiled in a dispute, any resulting settlement payment may need to be treated as part of the purchase price and capitalized, not deducted.

Conclusion

Nearly every piece of litigation eventually sprouts tax issues. It is tempting to just bring your dispute to an end and let the tax chips fall where they may. Whether you are a plaintiff, a defendant, or counsel for one, that can be a mistake. Before you resolve the case and sign, consider the tax aspects. Tax withholding, reporting, and tax language that might help you are all worth addressing. You will almost always have to consider these issues at tax return time the following year. You often save yourself money by considering taxes earlier.

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.
Many people don’t realize that every offer and sale of a security is required to either be (a) registered with the Securities and Exchange Commission (SEC); or (b) subject to an exemption from registration under the Securities Act of 1933, as amended (the Securities Act), under federal securities laws (“Small Business and the SEC”—a guide for small businesses on raising capital and complying with the federal securities laws). That requirement applies to the sale of securities to multiple high net worth individuals, the sale of a security to one person in a private transaction, the sale of a security to a family member and all offers and sales of securities of public and private companies, including organizations with only two or three persons. Furthermore, that requirement applies to an offer of a security which is ultimately rejected by a potential purchaser (SEC v. Howey Co., 328 U.S. 293, 328 (1946)). Notwithstanding the requirements described above, a significant number of offers and sales may be exempt from registration under the Securities Act as described in greater detail below.

In order to understand the registration or exemption requirements set forth above, one must first understand the definition of a “security.”

Definition of Security
Under Section 2(a)(1) of the Securities Act, the term “security” is defined as

any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

That definition is not meant to encompass everything that may be a “security” though, as the U.S. Supreme Court has made clear that the definition of “security” is “quite broad” (Marine Bank v. Weaver, 455 U.S. 551, 555-556 (1982)) and meant to include “the many types of instruments that, in our commercial world, fall within the ordinary concept of a security” (H.R.Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)).

Clearly though the offer and sale of stock, bonds, debentures, ownership interests in limited liability companies and most notes with a maturity date over nine months are considered “securities” (Section 3(a)(3) of the Securities Act).
Registration Process
In order to register a security under the Securities Act, a company must file a registration statement with the SEC. Typically the type of registration statement used for an initial public offering will be a Form S-1 Registration Statement (Form S-1). A Form S-1 includes two parts (Part I and Part II). Part I is the prospectus, the legal offering or “selling” document. In the prospectus, the “issuer” of the securities must describe in the prospectus important facts about its business operations, financial condition, results of operations, risk factors, and management. It must also include audited financial statements. The prospectus must be delivered to everyone who buys the securities, as well as anyone who is made an offer to purchase the securities. Part II contains additional information that an issuer does not have to deliver to investors but must file with the SEC, such as copies of material contracts, signatures of management and other representations.

Once an issuer files a registration statement with the SEC, SEC staff examines the registration statement for compliance with pre-established disclosure requirements set forth in the form of registration statement (i.e., in Form S-1 itself) and in Regulation S-K, but does not evaluate the merits of the securities offering or determine whether the securities offered are “good” investments or appropriate for a particular type of investor. Individual investors are required to make their own evaluation of the offering terms based on their own facts, circumstances and risk tolerance.

The SEC generally provides any comments or questions it has on the registration statement within 30 days after the filing date of the registration statement. The issuer then responds to the questions and comments and amends the filing to address issues raised. The SEC may then have additional comments or questions and the process repeats itself until the SEC advises that the issuer has cleared all of its comments and the registration statement can be declared “effective.” Once the offering is declared “effective” the offering described in the registration statement can proceed as a registered transaction. Additionally, once the registration statement is declared “effective” the issuer is subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), which requires the filing of annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports (for disclosure of certain material transactions which occur between the filing date of quarterly and annual reports) on Form 8-K. These filing obligations continue until the issuer falls below certain minimum record shareholder thresholds, subject to the requirements of the Exchange Act.

Exemptions From Registration
Instead of registering the initial offer and sale of securities under the Securities Act, a company can rely on an exemption from registration to avoid such registration requirements. Some of the most widely used federal offering exemptions are summarized below:

Section 4(a)(2) Exemption
Section 4(a)(2) of the Securities Act exempts from registration “transactions by an issuer not involving any public offering.” To qualify for this exemption, which is sometimes referred to as the “private placement” exemption, purchasers of securities must:

- either have sufficient knowledge and experience in finance and business matters in order to be considered a “sophisticated investor” (i.e., be able to evaluate the risks and merits of the specific investment), or be able to bear the investment’s economic risk;
- have access to the type of information normally provided in a prospectus in a registered offering under the Securities Act (for example, include similar information as would be required under Part I of Form S-1 described above); and
- agree to take the securities for long-term investment without a view to distribute the securities to the public, except pursuant to the applicable rules of the Securities Act relating to the resale thereof (including Rule 144 described below).

Additionally, except in a Rule 506(c) offering, described below, no general solicitation or advertising is allowed in connection with a Section 4(a)(2) offering.

If a company offers securities to even one person who does not meet the necessary conditions of a Section 4(a)(2) offering, the entire offering may be in violation of the Securities Act.

While the specific compliance with a Section 4(a)(2) exemption is somewhat open to interpretation, Rule 506(b) provides objective standards that can be relied upon to ensure that the requirements of Section 4(a)(2) are met.

Rule 506
Rule 506(b) of the Securities Act allows companies to raise an unlimited amount of money in private offerings if certain requirements of Rule 506(b) are met. Those requirements include prohibiting the use of general solicitation or advertising to market the securities; allowing the sale of securities to an unlimited number of “accredited investors” (described below); making knowledgeable persons available to answer questions of prospective purchasers; and requiring that investors receive “restricted” securities, i.e., securities which include a legend making clear that no sales of the securities can be made absent an exemption from registration (like Rule 144 as described below) or the registration of such securities under the Securities Act. Alternatively, if the company includes a private placement offering document which sets forth substantially all of the information that would be required in a registration statement under the Securities Act (including audited financial statements), a Rule 506(b) offering can be made to up to 35 non-“accredited investors.”

The SEC requires companies to file a Form D within 15 days of the first sale under Rule 506, which requires the disclosure of certain information regarding the offering, securities to be sold thereunder and management.

Under Rule 506(c), a company can broadly solicit and generally advertise the offering, but still be deemed to be undertaking a private offering within Section
4(a)(2) if all of the other requirements of Regulation D are met in the event: (a) the investors in the offering are all “accredited investors” (i.e., no non-“accredited investors” are allowed to participate in a Rule 506(c) offering); and (b) the company has taken reasonable steps to verify that its investors are “accredited investors,” which could include reviewing documentation, such as W-2s, tax returns, bank and brokerage statements, credit reports, and the like—which is a greater burden to meet versus the requirement for a Rule 506(b) offering that allows companies to rely on the self-certification of investors and potential investors that they are “accredited.”

“Accredited investors” under Rule 501(a) of the Securities Act include any individual that earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, or has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person’s primary residence); certain entities such as a bank, insurance company, registered investment company, business development company, or small business investment company; partnerships, corporations and nonprofits, which generally are required to have assets in excess of $5 million or have equity owners that are all “accredited investors”; and any trust, with total assets in excess of $5 million, not formed to specifically purchase the subject securities, whose purchase is directed by a sophisticated person.

Revised Regulation A

Regulation A is an exemption from registration for public offerings made by non-reporting companies, provided that offerings made pursuant to this exemption share many characteristics with registered offerings. In March 2015, in order to implement Section 401 of the Jumpstart Our Business Startups (JOBS) Act, the SEC amended Regulation A by creating two offering tiers: Tier 1, for offerings of up to $20 million in a 12-month period (which require less disclosures and no on-going reporting requirements compared to Tier 2 offerings); and Tier 2, for offerings of up to $50 million in a 12-month period (which requires that companies file annual, semiannual, and current reports with the SEC on an on-going basis). For offerings of up to $20 million, companies can elect to proceed under the requirements for either Tier 1 or Tier 2. There are certain basic requirements applicable to both Tier 1 and Tier 2 offerings, including company eligibility requirements, bad actor disqualification provisions and other matters. Additional requirements apply to Tier 2 offerings, including limitations on the amount of money a non-accredited investor may invest in a Tier 2 offering, requirements for audited financial statements and the filing of ongoing reports (as referenced above).

Securities in a Regulation A offering can be offered publicly, using general solicitation and advertising, and can be sold to purchasers irrespective of their status as “accredited investors,” subject to certain limitations on the amount that non-accredited investors” can invest under Tier 2 offerings. Securities sold in a Regulation A offering are not considered “restricted securities” (i.e., securities that must be held by purchasers for a certain period of time before they may be resold) for purposes of aftermarket resales. The SEC must issue a “notice of qualification” before any sales pursuant to a Regulation A offering (made on Form 1-A) can proceed, which requires that the SEC review the offering documents and results, in many cases, in the staff of the SEC providing questions and comments requiring amendments to a company’s offering documents, similar to the process of obtaining “effectiveness” of a Form S-1 filing as described above.

Crowdfunding

Crowdfunding allows companies to raise funding through a large number of small transactions. Under the JOBS Act crowdfunding provisions, companies are limited to raising $1 million in any 12-month period. Companies cannot crowdfund on their own, but are required to engage an intermediary that is either a registered broker-dealer or registered with the SEC and FINRA. These intermediaries are subject to a number of requirements including limiting the amount that can be invested based on an investor net worth. The only companies eligible for crowdfunding are companies that are non-Exchange Act reporting companies.

Resales of Restricted Securities

Assuming restricted securities are acquired pursuant to one of the private offering exemptions from registration described above, those securities are not freely tradable and can only be sold pursuant to an effective resale registration statement filed by the issuer or pursuant to a resale exemption from registration under the Securities Act. The main resale exemption used for the resale of restricted securities is Rule 144. Rule 144 provides an exemption that permits the resale of restricted securities if a number of conditions are met, including requiring that the holder of the securities paid the full acquisition price of such securities at least six months prior to any sale, assuming the issuer is a reporting company under the Exchange Act and is current in its filings and at least one year prior to any sale in the event the issuer is not a reporting company or not current in its filings, and provided that certain other requirements for resale are met not described herein. Rule 144 may also require a notice filing with the SEC prior to any sale of securities, may limit the amount of securities that can be sold at one time and may restrict the manner of sale, depending on whether the security holder is an “affiliate” of the issuer. An “affiliate” is a person that, directly, or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the issuer, and generally includes officers, directors and those persons who hold 10 percent or more of an issuer’s securities.

Conclusion

The process of complying with the rules and regulations relating to the offer and sale of securities is complicated and no exception from compliance with the federal securities laws is provided for small transactions or transactions involving family members. Instead, each and every offer and sale of a security is required to either be (a) regis-
stered with the SEC; or (b) exempt from reg-
istration under the Securities Act. As such,
a competent securities attorney should al-
ways be contacted prior to any offer or sale
of securities to determine and confirm that
all applicable rules and requirements are
being followed. Failure to comply with the
rules and regulations of the Securities Act
can lead to an issuer (and in some cases its
officers and directors) being subject to civil
and criminal penalties and fines and can
further create rescission rights for investors
in the non-compliant offering.

It should also be noted that the above
discussion is only a summary of applicable
rules and requirements and is for informa-
tional purposes only. Finally, the above only
discusses federal securities laws and issues
and readers should keep in mind that often
times the offer and sale of a security is gov-
erned by not only federal law, but also state
law, and that each state has their own offer-
ing and sale requirements, notice and filing
requirements and offering rules, all of which
should be confirmed prior to proceeding
with the offer or sale of any securities.

David M. Loev is Managing Partner
at The Loev Law Firm, PC. John S.
Gillies is a Senior Associate at The
Loev Law Firm, PC. Messrs. Loev and
Gillies have represented a variety
of public and private, small- to
medium-sized companies and have
experience with public and private
offerings of securities, SEC reporting,
mergers and acquisitions, initial
public offerings, up-listings to NYSE
& NASDAQ, proxy issues, and federal
securities law compliance.
In January 2017, Allergan Inc. agreed with the SEC that it would pay a $15 million fine for failing to disclose, in its Schedule 14D-9 response to the unsolicited tender offer for the company by Valeant Pharmaceuticals International, that Allergan was engaged in negotiations for possible “white-knight” transactions in the months following Valeant’s offer. The director of the SEC’s New York Regional Office set forth in a press release that Allergan had “failed to fully and timely disclose information about potential merger transactions it was negotiating behind the scenes in response to the Valeant bid.”

Allergan’s Schedule 14D-9 filing. In the Schedule 14D-9 filed by Allergan in response to Valeant’s unsolicited, public takeover bid, Allergan: (i) set forth that the Valeant bid was inadequate; (ii) recommended that its shareholders not tender their shares into the offer; and (iii) set forth that it “is not now undertaking or engaged in any negotiations in response to the [Tender] Offer that relate to or could result in a merger or other extraordinary transaction.”

The SEC’s objections to Allergan’s Schedule 14D-9 disclosure. The SEC had the following objections with respect to Allergan’s disclosures in its Schedule 14D-9:

- **No disclosure of discussions with “Company A.”** The Schedule 14D-9 was filed in June 2014. Thereafter, Allergan engaged in negotiations with Company A in August and September 2014 for a possible acquisition of Company A. The acquisition would have complicated Valeant’s offer by making Allergan a significantly larger company. The negotiations were terminated by Company A after it conducted due diligence on Allergan. The negotiations with Company A were never publicly disclosed.

- **No disclosure of discussions with Actavis plc until the merger agreement was signed.** On October 4, 2014, the respective CEOs of Allergan and Actavis discussed a potential acquisition of Allergan by Actavis. The Actavis CEO proposed that Actavis would pay $185–$200 per Allergan share. A series of conversations ensued through October, with Allergan insisting that the price had to be higher than $200, and Actavis making increasing price proposals. On November 3, Allergan disclosed that it had been approached by a party about a possible transaction, but provided no other information. On November 5, Allergan and Actavis entered into a confidentiality and standstill agreement, and Allergan permitted Actavis to conduct due diligence. The parties at that time understood that Actavis was proposing $210–$215 per share and that Allergan wanted more than $215. On November 6, Allergan disclosed that it was “in discussions” concerning a possible merger that “may lead to negotiations.” On November 17, Allergan and Actavis announced that they had signed a merger agreement at a price of $219 per share of Allergan. Importantly, as was noted in the SEC Order, after rumors about merger discussions with Actavis came to the SEC staff’s attention, the staff warned Allergan on September 23 that “to the extent that [Allergan] was engaged in merger negotiations, Schedule 14D-9 required those negotiations to be disclosed.” Thereafter,
the SEC staff had made repeated requests to Allergan to make timely disclosure of any ongoing discussions.

Key Points
Companies generally do not have an affirmative obligation to disclose white-knight discussions. Companies engaged in discussions or negotiations with respect to a possible transaction generally do not have a disclosure obligation. However, a disclosure obligation arises under the following circumstances:

- **Schedule 14D-9 filing is required.** If a tender offer is received by a company, it has an obligation to disclose, in the Schedule 14D-9 that is required to be filed in response to the tender offer, discussions or negotiations conducted in response to the tender offer.
- **Inconsistent past statements must be corrected.** In the case of a company receiving a bid that is not a tender offer, the company has an obligation to disclose such discussions or negotiations if the company has made inconsistent statements in the past that must be corrected—that is, affirmative statements made in the past that the company is not in discussions about a merger.
- **Agreement has been reached on all material deal points.** In some cases, an obligation to disclose discussions or negotiations may arise when all of the material deal points for a transaction have been agreed upon between the company and the other party.

Allergan’s disclosure obligation arose because it had received a tender offer. Disclosure issues arose for Allergan only because it was subject to the Schedule 14D-9 rules. The Schedule 14D-9 rules applied only because Allergan had become subject to a tender offer. In the case of a tender offer for a company, Item 7 of Schedule 14D-9 requires that the company disclose “negotiations” that are conducted “in response to [the] tender [offer]” and that relate to an “extraordinary transaction” (including a merger or acquisition). Rule 14D-9(c) requires that the company amend the Schedule if any material change occurs.

**Practical considerations with respect to Schedule 14D-9 disclosure of negotiations.** Schedule 14D-9 does not require disclosure of discussions with respect to a possible transaction unless they rise to the level of “negotiations.” When discussions become “negotiations” depends on the facts and circumstances, including, for example, whether there has been back-and-forth between the parties on price of a nature that suggests that a deal has been, or is very close to having been, reached. Generally, a company prefers to engage in a process that does not lead to its being required to make early disclosure of possible white-knight discussions. Premature disclosure could result in the company becoming irrevocably “in play” before it has made a final decision about selling the company; could lead to a potential white knight losing interest in a transaction; and/or could require disclosure, as an update, that would not otherwise have been required.

The following potentially distinguishing features of the Allergan situation may have influenced the outcome:

- **SEC disclosure warnings.** As noted, the SEC set forth in its Order that Allergan had failed to make timely disclosure “despite repeated requests” from the SEC staff that it make “appropriate disclosures.”
- **Extensive pricing discussions within a narrow range.** Unlike the typical case where price discussions occur in a very short timeframe just prior to execution of the merger agreement, it appears in the Allergan-Actavis discussions that there was extensive back-and-forth on price well in advance of execution of the merger agreement. Moreover, those discussions were within a relatively narrow range, suggesting that real negotiations had taken place.
- **Lengthy process, with unusual level of shareholder engagement.** The lengthy duration of Allergan’s process, extending over many months, made leaks and rumors about the process more likely. Further, the extensive engagement with shareholders—by both Allergan on the one hand, and Valeant and its shareholder activist co-bidder on the other hand—in connection with proxy contests on various issues relating to Valeant’s bid increased the visibility of the process to the shareholders, the market, and the SEC, perhaps heightening the disclosure issues.

Gail Weinstein, senior counsel in Fried Frank’s corporate department, was lead legal counsel on many of the seminal contested and negotiated transactions during the advent of M&A, has been at the forefront of market-shaping transactions.

Philip Richter is a corporate partner resident in Fried Frank’s New York office. Mr. Richter represents clients in mergers and acquisitions transactions involving both public and private companies, minority investments, proxy fights and unsolicited proposals, and strategic partnerships and joint ventures.

Warren de Wied is a corporate partner resident in Fried Frank’s New York office. Mr. de Wied is widely recognized as a leading advisor to corporate boards and public companies in M&A transactions, shareholder activism and corporate governance.

Scott B. Luftglass is a litigation partner resident in Fried Frank’s New York office. Mr. Luftglass’ practice focuses on representing corporations, boards of directors, special committees, financial advisors, senior management, and private equity funds in hostile and friendly takeovers, governance disputes, and shareholder and derivative litigation in federal and state courts.
Almost 12 years after the costliest disaster in U.S. history, New Orleans Mayor Mitch Landrieu spoke at the Business Law Section 2017 Spring Meeting luncheon in New Orleans on the efforts of his office to rebuild “one of the greatest cities in the world” after Hurricane Katrina. Expounding upon the guiding principles of not just the city of New Orleans, but of the country as a whole, Mayor Landrieu reminded lawyers in the audience of their duty to serve as protectors of those principles during the country’s trying times.

Mayor Landrieu, former legislator and lieutenant governor of Louisiana, spoke to the audience of more than 500 Section members with a sense of kinship, addressing them as “fellow brother and sister lawyers.” As a practicing attorney for 16 years, Mayor Landrieu said he understands the important role that lawyers play in upholding justice and feels strongly that our institutions are guided by this principle.

“I was asked to lead during a moment of greatest despair in New Orleans,” said Landrieu. “Hurricane Katrina was the worst man-made disaster in American history.” Landrieu emphasized man-made because “it began as a natural disaster, but when the levies broke, it became man-made.”

According to Landrieu, the city was 17 feet under water, and everything in New Orleans was lost, including schools, hospitals, and businesses. “We had to get my daughters to school the next day,” said Landrieu, “but many New Orleans institutions were destroyed. It was a moment of standstill: New Orleanians were forced to continue with everyday routine in the face of tragedy.”

Landrieu noted that the three to four years of recovery post-Katrina did not go well at first. However, recovery for the New Orleanians went deeper than rebuilding the city.

For Landrieu, it was the “most miraculous thing—we all realized that we were in the same boat. People that never talked to each other were joined together.” For outsiders, who thought the New Orleanians were “crazy” for not leaving in the hurricane’s wake, Landrieu summed it up: “We couldn’t leave even if we wanted to. The New Orleanians refusal to abandon the city, their way of life, their authenticity comes from our DNA, from the beginning of time.”

The authenticity of New Orleans—its citizen’s “heart and soul,” as Landrieu put it—was exactly what could not be lost during the rebuild. Since the hurricane and during his time as mayor, Landrieu proudly boasted that the city is growing faster than any city in the United States. There has been $1.8 billion invested into schools, 55 primary care clinics, two new university hospitals, and a new veteran’s hospital.

Although institutions in New Orleans have found their footing, Landrieu warned that the strength of American institutions will be tested in the coming years under the current political environment. “It will be a stress test on the Constitution,” said Landrieu. “The institutions and principles behind them have to stay strong, and lawyers will be the ones to protect them.”
New Orleans Diary

Before the Parade Passes By
Business Law Section meetings always provide me with unparalleled professional enrichment opportunities as well as the chance to catch up with old friends and make new ones. New Orleans exceeded expectations on both counts. It was wonderful to see the birth of a new committee—the Legal Analytics Committee—and experience the energy of all those in the room who met to plan the committee’s activities for the next year. Watching lawyers adapt to and embrace new technologies and new ways of doing business reminds me to encourage my law students to keep an open mind about how their practices might develop.

I cannot reminisce about New Orleans without mentioning the float parade that took us to the section dinner. I never thought I would have the chance to develop Mardi Gras bead-throwing skills with my fellow Section members. What a great way to bond! One question still nags me, however: Do the residents of New Orleans ever tire of being hit in the head by beads on random evenings?

Professor Juliet M. Moringiello
Harrisburg, Pennsylvania

Although the 2017 Spring Meeting’s substantive presentations were (as always) excellent, my favorite part of this meeting was most certainly the section dinner. The Mardi Gras themed event allowed us to experience some of the best aspects of New Orleans—a parade through the city, great southern food, and even better music and dancing—alongside colleagues and friends. It was such a fun and enjoyable way to socialize among colleagues with whom we work all year long.

Sara E. Bussiere
Bayard, Delaware

Laissez les Bons Temps Rouler
Albert Einstein based his theories on the space-time continuum and wrapped them in the fabric of space-time. Lawyers, on the other hand, live their lives along the somewhat less sexy billable-time continuum. From April 6 through 8, nearly 1,700 brave souls attended the 2017 Spring Meeting in
New Orleans. Cutting-edge legal issues were discussed, important connections were made, and ABA President Linda Klein graced us with her presence.

When the time came for the section dinner, however, attendees traded their business attire for casual clothes, rode to the dinner venue in Mardi Gras floats, ate and drank well, and danced the night away to the music of Rockin’ Dopsie & The Zydeco Twisters. A few (who shall remain nameless) even got on stage and sang and danced with the band. Rest assured that the billable-time continuum is safe, although I think we poked a few holes in the fabric of billable-time. How else could we have laissez les bons temps rouler?

David C. Rieveschl
New Orleans, Louisiana

Old and New Memories
My wife and I were happy to return to New Orleans for the 2017 Spring Meeting at the Hyatt Regency. Our daughter attended Tulane many years ago, but we had not been back much in recent years and were happy to see that the city has now almost fully recovered from the effects of Hurricane Katrina. The Hyatt Regency also holds some memories for us because the Superdome next door was the site of Tulane football games and our daughter’s graduation in the late 1990s, so we had stayed there before.

We walked the Moonwalk and the French Quarter from Jackson Square (and Café du Monde, of course) and were pleased to discover local jazz bands playing throughout the French Quarter. We are a little senior for Bourbon Street, but enjoyed walking and shopping on Royal Street, and my wife made a special trip to Rau’s, which has taken to advertising some of its higher-end antiques in the Wall Street Journal recently. We certainly sampled the regional cuisine—Arnaud’s Jazz Bistro, Antoine’s, Commander’s Palace for Sunday jazz brunch, and the Banking Committee’s dinner at Broussard’s. My wife even escaped the meetings to get to some local favorites, including Mother’s and Ralph’s on the Park.

Oh yeah, the ABA meetings and events! The Saturday night dinner at Mardi Gras World was spectacular, as was the experience of riding the floats to get there and launching the “throws” of Mardi Gras beads from the floats to astonished kids and other passersby on the street. As an architecture buff and longtime member of the Chicago Architecture Foundation, I now have very high expectations for the upcoming ABA Annual Meeting in Chicago.

William F. Kroener III
Washington, D.C.

New Faces and First Timers
My favorite memory from the 2017 Spring Meeting came during the First Timers’ Breakfast. I was asked to walk the attendees through the ABA Meeting App and show them how to use it. When I polled the room to find out how many of them knew about the app, I discovered that almost all of them not only knew about it, but had downloaded it and were already using it to plan their own Spring Meeting schedule. It served as yet another reminder of the outstanding work the Business Law Section does to engage all of its members.

Monty Garside
Atlanta, Georgia

My favorite moment in New Orleans was meeting so many other authors of new Business Law Section books at the luncheon. It was great to put faces to names and have the opportunity to get to know everyone in person.

Eric Epstein
New York, New York

As a first-time attendee, the 2017 Spring Meeting gave me the opportunity to network with colleagues from all over the world and learn something new. Most of the people at the event looked like they knew each other from previous events, and it was good to make these connections. On the casual side of things, “what happens in Vegas stays in Vegas; what happens in New Orleans never happened.”

Allan Jacobus Kobel
New York, New York
Title VII of the 1964 Civil Rights Act prohibits employers from discriminating against employees and job applicants based on five traits, including sex. Since 1994 Congress has often been urged to recognize sexual orientation as a protected trait, as several state laws do, but it has not done so. But on April 4, 2017, the Seventh Circuit Court of Appeals held en banc that Title VII outlaws sexual orientation discrimination. *Hively v. Ivy Tech Community College of Indiana.*

The court did so not by creating a sixth protected trait, but by ruling that sexual orientation discrimination is sex discrimination. *Hively* puts the Seventh Circuit squarely at odds with nine other circuits.

The word sex in Title VII has undergone quite a metamorphosis in 53 years. It was put in the original bill by a congressman who thought Congress would balk and kill the bill, but his amendment was approved without comment. Since then, with no legislative history to aid them, courts have had to discern the word’s meaning on their own. Early on they saw it as embracing only biological differences between women and men. But in the 1980’s, they adopted a broader, gender-based view; under it, sex includes socio-sexual roles and behavioral expressions such as masculinity and femininity. Courts also recognized sexual harassment as sex discrimination.

The next step was to view discrimination based on nonconformity with gender norms as sex discrimination, which the Supreme Court took in *Price Waterhouse, Inc. v. Hopkins* (1989). Nine years later, *Oncale v. Sundowner Offshore Services, Inc.*, held that Title VII reaches same-sex discrimination. Congress may not have had this in mind in 1964, the court said, but on its face the words “discriminate because of sex” in the act do not embrace only the opposite sex.

After *Oncale*, gay and lesbian employees who were harassed by coworkers seized on it and *Price Waterhouse* to get around the fact that sexual orientation is not a protected class. With increasing success, they urged courts to hold that even if one is homosexual, to harass that person because they don’t act, dress, or talk like members of their sex typically do is sex stereotyping. After that, courts were put to the hair-splitting task of discerning the motive for harassment: if it resulted from a belief that the target was gay there was no Title VII claim, but if it stemmed from perceived gender nonconformity a cause of action did exist.

In *Hively*, the court said that it was time to stop the legal gymnastics and to say flat out that sexual orientation discrimination is sex discrimination. To treat people differently because they prefer their sex to the other is the epitome of gender stereotyping, which is illegal under the rationales of *Price Waterhouse* and *Oncale*.

Concurring, Judge Posner tweaked the majority for claiming that it was carrying those decisions to their logical end. Better to say that courts may adapt statutory language to meet the felt needs of the time and be done with it. Predictably, the dissent argued that courts overstep their bounds if they usurp the legislative role, especially when Congress has a 23-year record of rejecting efforts to do what the majority did.

What’s in store in the future? Although *Hively* applies only in Wisconsin, Illinois, and Indiana, any en banc ruling, even one as controversial as this one will be, carries weight. It could be persuasive in some circuits that have ruled differently, especially as these are panel decisions. Several circuits have already been asked to take up this issue en banc.

That said, it is worth stressing that although the circuits have uniformly held that gender stereotyping is sex discrimination, nine are aligned against *Hively*. For all, or even most, to alter their position is hardly foreseeable, especially as each hung its hat on Congress’s inaction in this area. As well, although the Equal Employment Opportunity Commission has read Title VII as *Hively* did since 2015, how long it will do so under this administration is an open...
question. For it to go the other way would take wind out of the sails of the majority’s position.

Because there is a circuit split, the Supreme Court may weigh in. If it does and Justice Gorsuch remains the newest member, it could divide 4–4 with Justice Kennedy in the middle. Then the question would be which Kennedy shows up, the conservative or the author of so many pro-gay-rights rulings. It’s a close question, but in the end my money is on the proposition that what Congress has done in this area—or, more aptly, not done—would be decisive for him.

Jon Bible is a Professor Emeritus of Business Law at Texas State University–San Marcos who recently retired from full-time teaching after 32 years. His specialties are constitutional and employment law.
Assume the following hypothetical:

You are a senior partner at a large international law firm, headquartered in a major metropolitan city. Suddenly, there comes an urgent knock on the door of your corner office. One of the firm’s brightest young associates, upon your wave, comes bursting in and shouts out: “I have incredible news! The other side in our bet-the-company case has produced to us some ‘smoking gun’ documents which will turn the tide of the litigation!” Upon your questioning of the young lawyer, she tells you (i) the “smoking gun” documents reflect privileged communications between the opponent’s board of directors and the company’s attorneys, and (ii) that the materials were undoubtedly produced by mistake. She also tells you that she has looked into the applicable rule of professional responsibility (Rule 4.4(b)), and all that is required is the following: “A lawyer who receives a document or electronically stored information relating to the representation of the lawyer’s client and knows or reasonably should know that the document was inadvertently sent shall promptly notify the sender.”

What should you, the senior partner, do? Does it depend on the jurisdiction in which you sit? Does it depend on things beyond what the ethics rules say? Does it depend on the court in which the litigation is being waged? Why is one prominent legal academic who called Rule 4.4(b) a “model of clarity” so wrong? The answers to these (and other) questions follow below.

The first question you need to ask yourself is: where am I? Many states do not follow ABA Model Rule 4.4(b). For example, a number of states require that you: (i) stop reading the document; (ii) notify the sender; and (iii) abide by the sender’s instructions. Other states require something less than those three steps. And while some states do in fact follow the ABA Model Rule, still other states have no Rule 4.4(b) at all. This disparate kettle of fish tees up an ethical quandary for any lawyer who has clients beyond just the four corners of the state in which she is licensed: how does she comply with these very different ethical obligations vis-à-vis inadvertent disclosure?

The fourth sentence of Comment 2, the Rule drafters wrote the following:

Although this Rule does not require that the lawyer refrain from reading or continuing to read the document, a lawyer who reads or continues to read a document that contains privileged or confidential information may be subject to court-imposed sanctions, including disqualification and evidence-preclusion.

And in the third sentence of Comment 3, the Rule drafters wrote the following:

Substantive law or procedural rules may require a lawyer to refrain from reading an inadvertently sent document, or to return the document to the sender, or both.

Thus, if all you read is the “authoritative” Rule, but not the red-flagged Comments, you (the unsuspecting, but rule-compliant) senior partner might be “ethical,” but you could be facing some pretty unhappy consequences for blithely following this “model of clarity” Rule. And this is especially
so, given that you are dealing with privileged materials inadvertently produced.

A few years ago, the legal powers that be (with the assistance of Congress) made some changes to protect lawyers who are imperfect in dealing with the production of privileged material. First, the Federal Rules Advisory Committee adopted Fed. R. Civ. P. 26 (b)(5) (and analogous to it in Rules 16, 33, 34, and 37); and Congress thereafter adopted Rule 502(b) of the Federal Rules of Evidence. The rules codify that an “inadvertent disclosure” of privileged material does not operate as a waiver so long as (i) the privileged holder took “reasonable steps to prevent disclosure”; and (ii) the privileged holder took “reasonable steps to rectify the error.” Whether this “reasonableness” approach has led to the promised land is unclear; for example, “reasonableness” appears to be in the eye of the judicial beholder. Compare Rhodes Industries, Inc. v. Building Materials Corp. of America, 254 F.R.D. 216 (E.D. Pa. 2008) with Sitterson v. Evergreen School District of 114, 196 P.3d 735 (Wash. Ct. App. 2008) with Mt. Hanley Ins. Co. v. Felman Prod. Inc., 2010 WL 1990555 (S.D. W. Va. May 18, 2010) with Edelen v. Campbell Soup Co., 265 F.R.D. 676 (N.D. Ga. 2010). And the claw-back save haven provided by F.R.E. 502(d) has not appeared to have had much effect in obviating the risks of the “reasonableness” standard. See Spicker v. Quest Cherokee, 2009 WL 2168892 (D. Kan. 2009); see also J. Rosans, “6 Years In, Why Haven’t FRE 502(d) Orders Caught On?” Law360 (July 24, 2014).

As part of these reforms, Fed. R. Civ. P. 26 (b)(5) puts specific obligations onto the receiving lawyer once she is made aware of the production of privileged information: (i) she “must promptly return, sequester, or destroy” the material(s); (ii) she “must not use or disclose the information until the claim is resolved”; and (iii) she “must take reasonable steps to retrieve the information if the [receiving] party disclosed it before being notified.” (Interestingly, these requirements are similar to what the ABA prescribed prior to the promulgation of Rule 4.4(b). See ABA Formal Opinions 92-368 & 94-382.) About half of the states have imposed similar obligations on litigating lawyers in their jurisdictions. One that has not is New York State, which does not have the same or similar obligations in the Civil Practice Law and Rules. So New York litigators in New York federal courts would seem to have very different responsibilities with regard to inadvertent production than they would in New York State courts. And Virginia licensed attorneys also have their hands full. According to that state’s Standing Committee on Legal Ethics, an attorney who receives privileged materials inadvertently is not ethically obligated to return the materials to the sender, if “the confidential information [was] received in the discovery phase of litigation,” rather than “[o]utside of the discovery process.” See Opinion 1871 (July 24, 2013).

In addition, the above-mentioned federal and state protocols have left some open issues for all lawyers governed thereby. For example, does the receiving lawyer have an affirmative obligation to notify the sender, or may she wait until she is “notified” of the inadvertent disclosure? And can the receiving attorney reader the inadvertently produced material and/or share it with her client? Finally, what about privileged or confidential information that is overheard? (None of these rules seem to cover that scenario.)

Given the complexity and overlay of different (but related) concepts, it is perhaps not surprising that courts, in sorting out the various protocols, have not been uniform in their approach to dealing with inadvertent disclosure. Compare Lipin v. Bender, 597 N.Y.S. 2d 390 (1st Dept. 1993) (disqualification of attorney) with MNT Sales, LLC v. Acme Television Holdings, LLC, Index No. 602156/2009, NYLJ, p. 42, col. 5 (Sup. Ct. N.Y. Co. April 29, 2010) (use of material barred at trial) with Rico v. Mitsubishi Motors Corp., 171 P. 3d 1092 (Cal. 2007) (attorneys and experts disqualified) with Merits Incentive LLC v. Eighth Judicial District Court, 262 P. 3d 720 (Nev. 2011) (disqualification of attorney not ordered).

To help flesh out many of the foregoing points a bit more, a very recent judicial decision is instructive. In Harleysville Ins. Co. v. Holding Funeral Home, Inc., No. 1:15cv0057, 2017 BL 395 (W.D. Va. Feb. 2, 2017), a federal magistrate judge denied plaintiff’s motion to disqualify defense counsel. The litigation arose out of a dispute about insurance coverage relating to a funeral home’s fire. An employee for the insurance company put the entire case file (which included privileged materials) on an unprotected file-sharing site (which had no password protection), and then emailed a link to the site to the company’s outside investigator. Defense counsel issued a subpoena to the investigator, and its production in response included the e-mail listing the link. Defense counsel (i) first accessed the case file, and (ii) later produced the case file back to the insurer; the latter of which led to the motion to disqualify, as well as to motion practice on whether the insurer could claim a non-waiver under F.R.E. 502(b).

With respect to the Rule 502(b) issue, the magistrate judge focused (as highlighted above) on the “reasonableness” of the insurance company’s actions to protect the privileged materials. Based upon “material facts... not in dispute,” the magistrate judge determined there was “no evidence... that any precautions were taken to prevent this disclosure.” (emphasis by the court) By making the case file “accessible to anyone with access to the internet,” with no password protection, the insurance company failed the most basic tenet of “reasonableness”; as the magistrate judge concluded: “It is hard to imagine an act that would be more contrary to protecting the confidentiality of information than to post the information to the world wide web.” (The magistrate judge also ruled that there was a waiver of any attorney work product on similar grounds.)

Turning to the disqualification motion, the magistrate judge then ruled that the actions of defense counsel were improper under federal and Virginia procedural rules, as well as under operative Virginia ethics opinions (including Opinion 1871). Given that the e-mail link to the file-sharing site had a prominent “Confidentiality Notice” (which included this language: “This e-mail contains information that is privileged and confidential, and subject to legal re-
strictions and penalties regarding its unauthorized disclosure or other use.”), defense counsel (i) should have contacted plaintiff’s counsel about its access to the case file, and (ii) should have sought the court’s guidance as to whether there had been a waiver of applicable protections, before making use of the information. [All defense counsel had done was to call the Virginia State Bar Ethics Hotline for advice, action which, in the words of the magistrate judge, “believe[d] any claim that they believed that their receipt and use of the materials . . . was proper under the circumstances.”]

As to a sanction, the magistrate judge ruled that disqualification would be pointless, since “based on the court’s ruling on waiver, substitute counsel would have access to the same information.” As such, she found that “the more reasonable sanction is that defense counsel should bear the cost of the parties in obtaining the court’s ruling on the matter.”

**Conclusion**

In light of all of the foregoing, a number of concerned folks have suggested that the ethics gurus should go back and articulate a better (and more transparent) set of standards to govern how to handle inadvertent disclosure. But there has been significant pushback to that suggestion—on the ground that such a step “would be a step backwards.” According to one commentator, “[a] profoundly important argument for limiting the scope of lawyers’ ethical obligations in these situations is the unfairness of making the ‘innocent’ lawyers who receive such communications potentially subject to professional discipline in situations not of their making; according to this pushback argument, ‘vagueness is preferable to . . . any broader rule.’” See A. Davis, “Inadvertent Disclosure—Regrettable Confusion,” *New York Law Journal* (November 7, 2011).

Who is right in this debate? Who knows. What I do know is that, at present, inadvertent disclosure is one tricky and sticky wicket for any lawyer who gets caught up in it unaware.

**C. Evan Stewart** is a senior partner at Cohen & Gresser in New York City. He is an adjunct professor at Fordham Law School and a visiting professor at Cornell University.

“Ethics Corner” is sponsored by the Professional Responsibility Committee, and is edited by Robert Evans III, a partner at Shearman & Sterling LLP.
Member Spotlight: An Interview with Therese Franzén

Therese Franzén has delved into nearly every corner of the law—working as a prosecutor, a partner at a firm, a general counsel, and cofounder of a firm and also a company, a mortgage quality control and compliance company. She’s also found time to do pro bono work in Mexico, Haiti, and her hometown of Peachtree Corners, Georgia. Throughout, the ABA has been critical to her legal career. “The people whom I know through the ABA are really the movers and shakers in their field,” she says. “It’s great to be able to learn from people who are so well-respected.”

* * *

What inspired you to become a lawyer?
It was probably my mother. She was a forensic chemist, one of the few mothers who was a working mom when I was growing up. She investigated crimes and then testified around the world for the U.S. Armed Services.

Did she talk about her work with you?
She did, to a certain extent. There were a few cases that were fairly well publicized, so we heard about those. She also traveled quite a bit for her job, and so because of that, if she was going to testify in a particular case, she would tell us a little bit about it. Of course when I was in law school I thought I would be a criminal defense lawyer. Instead I became a consumer financial services attorney.

You’ve worked as a government lawyer. How was that experience?
When I first graduated from law school, I got a job as a prosecutor, where I stayed for two years. I prosecuted misdemeanors. The biggest cases we had in the misdemeanor realm had to do with domestic violence. So I put together a protocol with the police, the hospital, and the battered women’s shelter, so women would be encouraged to go through with the prosecutions. As you may know, it’s a cycle, that’s the best way to put it. The woman is beaten, the man goes to jail, Monday morning comes around, and oh gosh, he’s sorry, he won’t ever do it again. So one thing I did was have the women talk with me, without the man being there. I’d give them information that hopefully would help them in the future, so they would know whom to call if they had a problem in the future. It worked out pretty well.

What did you enjoy about this?
It was so fun. It was exciting; I tried a lot of cases, which I really enjoyed. It was different every day. We worked really hard, because the case you were prepared to try always plead out, so then you had to pick up another case, which you had glanced at, and you tried that one instead. I worked with some really great people and great investigators. The judges were really good. I felt lucky to have that experience right out of law school.

Did it help prepare you to be a litigator, because you were in court so often?
It did. Even though I went into private practice and I did civil litigation, I had a lot more trial experience than other people in the firm.

After working at a law firm, you served as general counsel at Fleet Finance. I wanted you to list some of the difference between working as a general counsel versus a lawyer at a law firm.
The biggest difference is that being an in-house lawyer, you’re much more integrally involved in your clients’ decisions. I was very involved, not just in giving legal advice, but in the decision-making process itself. My experience has been that no matter how closely you work with a client as an outside lawyer, it’s just not the same depth of a relationship and depth of involvement in those business decisions that you have as an in-house lawyer.

Did you enjoy it?
Yes, that’s one of the things I missed when I started my firm. I had been with a law firm and was a litigator for several years prior to going in-house. I was in court or depositions all the time. When I went in-house, I was sitting there at my desk, and I went to my boss, the general counsel, and I said, “OK, I’ve got to get out of this office. Can I just at least go to the law library?” So I would go to the Emory Law Library and hang out there for a while. But after a
while, I got more involved at the company with meetings. Then when I went back to being outside counsel, I missed the business end of things.

What did you enjoy about managing the commercial litigation department at a law firm? And what didn’t you enjoy?
The reason I decided to go in-house was because I stupidly thought I would not work the same number of hours per week. For a while, I would say that was true. At my firm, I’d been working pretty much seven days a week. I’d have a second child, and that was when I decided I just can’t do this any longer. I can’t have two little kids and work seven days a week, and have the kind of life that I really wanted to have. I had friends who were in-house, and they had much more regular hours. I started looking for an in-house counsel position and really lucked into it. They happened to be looking, and I was looking, and I had limited my search to a certain geographical area in Atlanta.

In 1997 you cofounded your firm, Franzén and Salzano. What made you want to launch your own firm?
The immediate motivation was that our company was being shut down in Atlanta, so I had a choice. I could either move to the northeast, where there was an office that was part of Fleet Financial Group. But my husband was a judge, and he was not moving to the northeast. So I started looking for another job as an in-house lawyer. I had an interview at a large television station in the Atlanta area, which another really large conglomerate had just announced it was purchasing. At the interview, I looked at the guy who was interviewing me, and I said, “Well, how do you know you all are still going to even have a legal department in Atlanta? What if they move everybody to New York?” He looked at me and it was apparent he had never considered that the acquiring company might shut down this legal department in Atlanta. I said, “You know why I’m looking for a job? Because they’re shutting me down in Atlanta.”

I went back to the office and found my friend, Loretta, who worked at the company with me. I said, “I’m going to open a law firm, do you want to do it?” She said, “Sure.” So that’s how we started.

What are the challenges of having your own firm?
We’ve just been really lucky. When the economy took a downturn, we were worried about that, but we always had a balance in our firm between litigation, enforcement work, and compliance work. It always seemed when one area was down a little bit, the other area would be up. I would recommend and have told other people, don’t put all your eggs in one basket. Even though we have a very niche practice, we have a balance.

What are the benefits?
The biggest benefit is independence. You pretty much do what you want to do. It’s the ability to control your own destiny. If you see that you need to make some changes, then you’re able to do that. We’ve always been pretty small, which allows us to be nimble, to be very responsive to the clients.

If you could change one thing about your legal career, what would it be?
I’m a person who says I don’t want to have regrets about things. That said, we represent banks, mortgage companies, but it probably would have suited me better to have a more people-oriented practice. When I was looking for jobs out of law school, I was really interested in working for legal aid. Helping others is a personal need, which I’ve been able to fulfill in other areas of my life.

In 2008 you cofounded ComplyShare LLC, a mortgage quality control and compliance company. What inspired you to form this company?
We were inspired by our clients, who kept asking us to do it. If you’re a mortgage company, there’s a requirement for quality control review on 10 percent of your loan originations. There are companies out there who do that. Our clients kept saying, “Why don’t you all do this?” So, after some persuasion, we agreed. From there, we started to do more intensive file reviews, such as fair lending reviews, where we review the clients’ policies and procedures, as well as files, and make recommendations. Five years ago, we sold the quality control piece to another company and kept the more intensive analysis piece.

You do a lot of pro bono work. What do you do, and why is it important to you?
As a firm, we have traditionally represented nonprofits that provide transitional housing services to homeless families. I also represent my church pro bono.

Has that fulfilled your desire for a more people-oriented practice?
It has, because I feel that those entities are trying to help people. I also do volunteer work, such as building houses in Juarez, Mexico. I started doing that in 2001. Then, when things got bad in Juarez, I started going to Haiti. I’ve been going to Haiti now for ten years, and we have a school there, through my church. Then we started medical, dental, and eye clinics, which last year we spun off into a non-profit. I’m the board chair of that non-profit. In the states, I volunteer at a women’s prison and serve on the advisory board of a refugee resettlement non-profit, and these also have been extremely fulfilling.

I hear you are planning to retire, at least from the law firm. Is that right?
I am mostly retired now and trying to finish up a few lingering matters.

What are your plans for retirement?
My husband was retiring, so that was the immediate nudge. I always told him I was not going to be going to work every day if he was staying home. He did fully retire, except now he’s a senior judge and still hears cases. But for me, because of the kind of practice that I had, I can’t just cut it off, so I’ve got a few things still active. We want to travel, we love to travel. We just got back from Israel and Jordan on Saturday night. We have trips planned to Kenya and Tanzania in the summer and Europe in
the fall, with some shorter U.S. trips in the interim. And, I will make two trips to Haiti this year, and one to Cuba for my non-profit and church work.

You’re also very active with the ABA in addition to everything else you’re doing. What’s been the value of the ABA to you?

I originally got involved because of the CLE. In Georgia, there are very few CLE opportunities that are relevant to my practice. I’ve been a member of the ABA ever since law school, but got actively involved when I went in-house and needed to be able to talk with other people who did the same kind of work that I did. But the reason I continue is the relationships that I’ve built over the years with people. It’s just a great networking opportunity. The people whom I know through the ABA are really the movers and shakers in their field, and it’s great to be able to learn from those people who are so well-respected. They’re deep thinkers in their particular area of the law, and are very willing to share that with other people.

You were involved with producing the In the Know webinars for the ABA. Can you tell us about that?

It’s a free CLE webinar, which is produced monthly. In the Know is really geared to an intermediate to an advanced level practitioner. About a year ago, we started another series called Business Law Basics. It’s also a free webinar with CLE credit as a member benefit, but it’s geared to newer practitioners, either younger lawyers or practitioners who are new to that particular area of the law.

What do you do for fun?

I like to read, I’m in a book club, that’s very fun. We’re in the middle of selling our house, that’s not that fun. We’ve lived in this house for 22 years, so we have a lot of stuff to get rid of. We have a mountain house and we’re moving there. I like to work out, and I’ve been able to work out more since I’ve been mostly retired, so that’s really nice.

Is there anything else you’d like to add?

I encourage people who are ABA members to bring along a colleague, a friend, and introduce other people to the ABA, so that others can see the benefits of getting involved.

You really get the benefits when you become involved. If more people became involved, by going to meetings, or participating in the free webinars, and availing themselves of the benefits that the ABA offers, they would more than benefit from that themselves. They’d meet a lot of nice people, and maybe enjoy their own practice more.

Thank you so much!
Inside Business Law

This month’s “Inside Business Law” highlights the five most in-demand programs from the 2017 Business Law Section Spring Meeting held in New Orleans, Louisiana, April 6–8.

**The 2017 Business Law Section Spring Meeting**

Those who would like to enjoy Spring Meeting programing can access the written materials and audio recordings from more than 85 committee-sponsored CLE programs in the Program Materials Library now. Overviews of the five most in-demand CLE programs are presented below with links to program materials for each.

“Too Much or Too Little? Is the CFPB Exercising its Enforcement Power Appropriately?”

This program addresses issues regarding the CFPB’s approach to administrative enforcement, with a focus on whether its enforcement actions are sufficient or too great, and whether it is engaged in rule-making through enforcement. Presented by Banking Law and Consumer Financial Services.

“The State of Consumer Protection Initiatives and the Bank Examination Privilege”

Federal and state financial services regulators uniquely coexist to examine and supervise financial institutions, establish compliance policy and rulemaking, and educate consumers. Despite ongoing debate, the prevalence of regulatory violations by prominent financial services providers underscores federal and state regulators’ mission to protect American consumers. The expert panel addresses significant, recent regulatory violations or observations, and discusses how those findings have informed their distinct compliance examination, enforcement, and educational initiatives. Additionally, the panel discusses recent evidentiary issues in the application of the bank examination privilege and subsequent effects on banking litigation and regulatory initiatives. Presented by Banking Law and Consumer Financial Services.

“The CFPB at Six Years: Reflections on Jurisdiction, “Abusive,” and the Election’s Impact”

The panel reviews the CFPB’s enforcement cases and supervision actions that drew jurisdictional challenges and industry scrutiny, including cases alleging “abusive” acts and practices. The panel includes some of the earliest CFPB employees, who also discuss President Trump’s approach to the CFPB and its regulations. Presented by Consumer Financial Services.

“Blockchain Technology and Privacy”

The panel explores the intersection of privacy and blockchain technology. The panel discusses ownership and control structures for blockchains, the interplay between user anonymity/pseudonymity and regulatory compliance and whether blockchain transparency imposes the limits on privacy for participants. Presented by Consumer Financial Services.

“Charters, Partnerships, and Beyond: The Changing Landscape of FinTech Bank Licensing Strategy”

This panel discusses the shifting landscape for FinTech companies choosing among licensing strategies. The discussion includes legal developments affecting viability and attractiveness of bank partnerships and charters. It also considers key factors driving the decision for different types of firms, including lending vs. payments, and consumer vs. small business customers. Presented by Banking Law and Consumer Financial Services.

Register for the 2017 Business Law Section Annual Meeting

Join the Business Law Section in Chicago on September 14–17 for the 2017 Section Annual Meeting. Register now to expand your network of business law professionals, experience over 70 CLE programs and attend committee meetings and events.
Business Law Today Board Members 2016–2017

Co-Chairs:
Michael St. Patrick Baxter  
Covington & Burling LLP  
mbaxter@cov.com

Phillip J. Long  
Branch Banking and Trust Company  
pjlong@bbandt.com

Advisor:
Robert Boehm  
Steiner Leisure Limited  
bobb@steinerleisure.com

Members:
Sharmin Arefin  
The Arefin Law Office  
sarefin@arefinlaw.com

Kathleen J. Hopkins  
Real Property Law Group, PLLC  
khopkins@rp-lawgroup.com

Mitchell L. Bach  
Eckert Seamans Cherin & Mellott, LLC  
mbach@eckertseamans.com

Kathleen S. McLeRoy  
Carlton Fields  
kmcleroy@carltonfields.com

Cara Bradley  
Xylem Inc.  
cara.bradley@xlyeminc.com

Bradford K. Newman  
Paul Hastings LLP  
bradfordnewman@paulhastings.com

Penny Christophorou  
Cleary Gottlieb Steen & Hamilton  
pchristophorou@cgs.com

Jacqueline Parker  
Synchrony Financial  
Jacqueline.Parker@syf.com

Judge Jean Fitzsimon  
US Bankruptcy Court Eastern District of Pennsylvania  
Judge_Jean_FitzSimon@paeb.uscourts.gov

Michael K. Reilly  
Potter Anderson & Corroon LLP  
mreilly@potteranderson.com

Lawrence A. Goldman  
Gibbons P.C.  
lgoldman@gibbonslaw.com

Sankeetha Selvarajah  
Selvarajah Law P.C.  
sankeetha@gmail.com

Kristin A. Gore  
Carlton Fields Jorden Burt  
kgor@cfjblaw.com

John H. Stout  
Fredrikson & Byron, P.A.  
jstout@fredlaw.com

Nicole Harris  
Pacific Gas and Electric Company  
ndh1@pge.com

Roberta G. Torian  
Reed Smith  
rtorian@reedsmitc.com

Manager, Content Development:  
Production Associate:
Rick G. Paszkiet  
rick.paszkiet@americanbar.org  

Rachel Kahn  
rachel.kahn@americanbar.org