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#NotMe: Sex, Reps and Remedies

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#MeToo shows no signs of abatement. Indeed, what started as a social movement focused on ethics and character, has evolved into an economic headwind. It has also caused—or should cause—companies and their boards of directors to confront both the top- and bottom-line costs of workplace sexual harassment, including in the context of mergers and acquisitions (M&A).

Generally, decisions by boards of directors are insulated by the business judgment rule: the presumption that, in making a business decision, directors act on an informed basis, in good faith and in honest belief that the action taken was in the best interest of the company. However, under Delaware law, if a "sale of a company" or "sale of control" is in question, then the *Revlon* doctrine is triggered and courts apply enhanced scrutiny in determining whether the short-term interests of stockholders in maximizing the immediate value of the company have been achieved.

In the M&A context, the strength and power of #MeToo has elevated sexual harassment into a distinct economic risk and, in some circumstances, a deal-breaker. Sexual harassment risks, known, unknown, potential, real or perceived, should be carefully assessed and addressed by both sellers and acquirers.

Sex: Uncomfortable Questions

In M&A due diligence, both sellers and acquirors look beyond their counterparty's financial statements so as to be able to put a price on intangible risks and assets. Any threatened or pending litigation or insurance claims, including over sexual harassment, should be reviewed

and considered during pricing discussions. Importantly, in the #MeToo era, even informal allegations of sexual misconduct can diminish a company's brand and cause real financial impact. In this environment, "social due diligence" should be conducted in assessing the risk of future allegations.

Social due diligence typically covers everything from employee reviews to social media and should include a sober assessment of whether a company's human resources department and policies allow for a culture permissive of sexual harassment. Red flags include:

- company documentation of a pattern of misconduct
- employment agreements entitling executives to severance packages in spite of sexual misconduct
- many separation or settlement agreements that could relate to sexual harassment and contain non-disclosure agreements
- difficulty recruiting or retaining women, in particular at senior levels
- complaints about work culture or specific individuals
- evidence that serious allegations are not made to human resources
- allegations of sexual harassment that are suppressed or unaddressed.

Sellers should know what they are selling and proactively take steps to avoid diminution of value to their stockholders that can be caused by workplace sexual harassment. Acquirors should be armed with the knowledge to price the #MeToo risk. In the world of M&A, "don't ask, don't tell" is not an option for either seller or buyer.

Reps: Ask and Then Tell

Following a diligent assessment of sexual harassment risk, merger parties must determine who will assume that risk during and after the closing of the proposed business combination transaction.

In 2018, many acquirors requested that targets provide a "#MeToo rep": a representation that no credible accusations of sexual harassment had been levied. Variations as to who "knew or should have known" and to whom the representations apply (i.e. executive officers or all employees) and for what period of time such representations were covered are based upon fact-intensive scenarios. Merger parties have incorporated a version of the #MeToo representation in transactions across a wide variety of industries, from banking, financial technology and private equity to restaurants, health care and even photoprinting. However,

while there is yet to be a boilerplate #MeToo rep, there is a commonality: parties are making direct efforts to limit financial exposure to damages relating to past sexual harassment. Examples include:

> *"To the Company's Knowledge, in the last ten (10) years, (i) no allegations of sexual harassment have been made against any officer of the Company, and (ii) the Company has not entered into any settlement agreements related to allegations of sexual harassment or misconduct by an officer of the Company."*

> *"Except as set forth on Schedule [x], none of the [specified] Entities is party to a settlement agreement with a current or former officer, employee or independent contractor of any [specified] Entity resolving allegations of sexual harassment by either (i) an officer of any [specified] Entity or (ii) an employee of any [specified] Entity. There are no, and since [a specified date] there have not been any Actions pending or, to the Company's Knowledge, threatened, against the Company, in each case, involving allegations of sexual harassment by (A) any member of the Senior Management Team or (B) any employee of the [specified] Entities in a managerial or executive position."*

> *"The Company and each of its Subsidiaries has promptly, thoroughly and impartially investigated all sexual harassment allegations of which it is or was made aware. With respect to each such allegation with potential merit, the Company or its Subsidiary has taken prompt corrective action that is reasonably calculated to prevent further harassment. The Company does not reasonably expect any material liability with respect to any such allegations."*

Targets with a robust human resources department and whistleblower policies are better positioned to limit the scope of a #MeToo rep than those without. Target boards can and should ask for regular reports from senior management on whether and how cultural workplace issues arise and how they are addressed. Buyers are likely to request the same. In certain types of transactions, if specific language and structure is being used to create a true new employment relationship with employees, or for new hires from unrelated third parties that might be brought on in connection with a deal, an acknowledgement from the new employees that they did not engage, condone or neglect to address, in any way, sexual misconduct allegations at a prior employer can offer some protection. In today's environment, nonmoney issues are in fact money issues.

Knowledge is power, and the only way for a seller to mitigate its assumption of sexual harassment risk is to know what the risk is. Conversely, if targets have not paid attention and actively addressed the prospect of sexual harassment issues, then buyers should be sure to aggressively leave that the risk to sellers.

Remedies: Or Pay the Price

#MeToo reps should provide acquirers with a remedy against breach by targets of their moral contractual obligations to guard against and respond appropriately to claims of sexual harassment. The target should indemnify, protect and hold harmless the buyer for any breach of a #MeToo representation, just as it would for other negotiated representations and warranties.

However, in high-risk transactions or transactions with counterparties unwilling to provide the safeguards above, acquirors should consider additional remedies such as clawbacks from the purchase price, escrow amounts, or future executive compensation, as insurance against future losses connected to allegations of sexual harassment. Such remedies should be enforceable upon any such allegation that harms the company's reputation, operations or financial results, even if the allegations do not result in a successful lawsuit or settlement against the company. As the victims of sexual harassment in the workplace can confirm, such lawsuits and settlements are extraordinarily difficult to win, and the lack of a judicially sanctioned remedy does not mean that harm was not done.

In the event that a specific officer or director has been accused of a pattern of sexual harassment or assault, such that no representations or certifications could adequately protect a counterparty in an M&A transaction, the counterparty could negotiate for the removal of that person or plan to do so immediately upon taking control. Companies may find it easier to oust such individuals when the tradeoff for shareholders is a lucrative business combination transaction. Conversely, if there is a person or group of persons that are so intrinsically key to the company's prospects, strategic planning will be required to find a solution that addresses all the issues. Where there is no evidence of harassment, but a lack of protections are found, it may be prudent for an acquiror to negotiate a right to the termination of certain key persons in the event of a sexual harassment claim and increase the role of human resources, possibly including revising policies and procedures as well, before a change of control.

#NotMe

#MeToo, among other things, has been a catalyst for the creation of tangible financial penalties for failure to prevent sexual harassment in the workplace. Companies that ignore the risk or reality of sexual harassment do so at the potential peril of their boards of directors and their stockholders. Conversely, companies that actively consider and address sexual harassment will be better positioned to rep #NotMe.

We refer you to our Directors' Guide to responding to the #MeToo movement and encourage companies to improve their decision-making and prevent gendered "group think" by increasing gender diversity on their boards of directors and among officers and managers.

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