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MASSIVE DERIVATIVE SUIT SETTLEMENT FOR ALLEGED MANAGEMENT FAILURE TO PREVENT SEXUAL MISCONDUCT

Recent news headlines have been dominated by appalling revelations that leading politicians, entertainers, political candidates and others have engaged in sexual harassment, assault, and other unacceptable behaviors. As these stories have emerged, a dynamic has evolved in which the victims come forward with their stories and seek to hold the wrongdoers accountable for their misconduct. Now, a blockbuster settlement suggests that this dynamic may not be limited just to attempting to hold individuals accountable, but may also involve efforts to hold the wrongdoers' companies' executives accountable for allowing the misconduct or for turning a blind eye.

In what is one of the largest shareholder derivative settlements ever, senior officials of 21st Century Fox have agreed to a $90 million settlement (funded by insurance) arising from allegations that the company's management permitted a culture of sexual and racial harassment to permeate the company, ultimately resulting in financial and reputational harm to the company. The settlement includes provisions for governance and compliance enhancements, including the creation of a Workplace Professionalism and Inclusion Council. The procedural circumstances of the settlement are interesting as well, as the settlement arises out of a lawsuit that had been threatened, but not filed, until the same day as the settlement agreement was submitted to the court.

BACKGROUND

The lawsuit relates to allegations raised by numerous women who worked for the company alleging that they had been sexually or racially harassed or retaliated against. In July 2016, former Fox News reporter Gretchen Carlson had filed a lawsuit for sexual harassment and wrongful termination, alleging that Fox News CEO Roger Ailes had harassed and retaliated against her. Her allegations led to an internal investigation of Ailes, which in turn led to his departure from the company pursuant to a separation agreement under which Ailes was paid substantial sums. Shortly thereafter, the City of Monroe Employees' Retirement System filed a Section 220 books and records request with the company seeking documents relating to Carlson's allegations and Ailes separation from the company.

Over the ensuing months, the company produced a volume of documents in response to the books and records request. While this process was proceeding, other company employees came forward with further harassment and retaliation allegations against Ailes, Fox News commentator Bill O'Reilly, and others. Ultimately, counsel for the Retirement System served a draft proposed derivative complaint on the company's counsel. As further revelations and allegations emerged, the Retirement System's counsel prepared and provided the company updated and amended draft proposed derivative complaints.

In the summer of 2017, the parties entered into a mediation, which, with further negotiations, resulted in the settlement. The stipulation of settlement was filed with the Delaware Court of Chancery on November 20, 2017. That same day, counsel for the Retirement System for the first

CONTACT
RT SPECIALTY
180 North Stetson Avenue
Suite 4600
Chicago, IL 60601
O: 312-784-6001
www.rtspecialty.com

time filed a Verified Derivative Complaint with the Delaware Court. In other words, the settlement was reached in resolution of a lawsuit that had been threatened but not yet actually filed with the court until the settlement was completed and filed with the court.

THE LAWSUIT

The complaint names as defendants Rupert Murdoch, his two sons, Lachlan and James, the company's other directors, and the estate of Roger Ailes (Ailes died on May 18, 2017). The complaint contains six separate claims for relief, alleging breach of fiduciary duty against the individual defendants and unjust enrichment against the estate of Roger Ailes (The unjust enrichment count relates to the separation payments the company agreed to pay Ailes at the time of his departure from the company).

The complaint alleges the existence of a "systemic, decades-long culture of sexual harassment, racial discrimination, and retaliation that led to a hostile work environment at Fox News Channel." The hostile environment was "created and facilitated by senior executives at Fox News." The complaint alleges that the company's board "did not take steps to address workplace issues such as sexual harassment and racial discrimination" and "failed to implement controls sufficient to prevent the creation and maintenance of this hostile work environment." The complaint alleges further that the company's senior officials "failed to implement sufficient oversight over the workplace" at Fox News to "prevent massive damage to the Company." The company's top executives allegedly failed to meet their "fiduciary duty to monitor developments at its most important business unit, investigate when red flags appeared, or put in place protocols that would have ensured greater visibility into the hostile work environment at Fox News."

Public revelations of a "toxic work culture" led to "numerous sexual harassment settlements and racial discrimination lawsuits" and to the "departures of talent and damage to good will." Among other things, the complaint also alleges that the Company has paid over $55 million in settlements for sexual harassment and racial discrimination. The complaint alleges that the toxic work culture the senior management permitted also caused the company other substantial harm, including the severance or termination payments the company agreed to pay to Ailes and O'Reilly as well as an estimated $20 million in related litigation costs. The complaint alleges that the overall financial harm to the company as a result of the defendants' alleged breaches of fiduciary duty exceeded $200 million.

THE SETTLEMENT

The settlement provides that the individual defendants and the Ailes Estate will "cause their insurers to make a payment" to the Company of $90 million. The settlement also provides for the implementation of governance and compliance enhancements at the company. Among the key elements of these governance and compliance enhancements is the creation of the Fox News Workplace Professionalism and Inclusion Council that will, according to the company's press release, be comprised of "experts in workplace and inclusion matters" to advise Fox News and its management "in its ongoing efforts to ensure a proper workplace environment for all employees and guests," as well as to improve reporting, workplace behavior, and recruitment of women and minorities. The Council is to be composed of four individuals including a former U.S. District Court Judge and other experts in HR and diversity matters.

The settlement stipulation expressly provides that the settlement "shall not be deemed a presumption, concession, or admission by any Defendant of any fault, liability, or wrongdoing." The settlement is subject to court approval.

DISCUSSION

This lawsuit and its settlement represent a substantial statement that the current, ongoing revelations of sexual misconduct will mean not only that the individual bad actors will be held accountable, but also that corporate executives and company officials who permitted the behavior or turned a blind eye may also be held accountable.

As the plaintiffs' counsel put it in the brief filed in support of their motion for court approval of the settlement, "Corporate boards can no longer pretend that such conduct is isolated, nor can corporate boards pretend that such conduct does not and will not pose a grave risk to companies and their shareholders."

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RT SPECIALTY
180 North Stetson Avenue
Suite 4600
Chicago, IL 60601
O: 312-784-6001
www.rtspecialty.com

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The non-monetary portion of the settlement is interesting and obviously is the part that both the company and the plaintiffs' counsel have chosen to emphasize. However, the cash portion of the settlement is interesting in its own right as the settlement is among the largest derivative settlements.

As substantial as the amount of the cash payment is, it should be emphasized that the cash portion of the settlement apparently will not be funded in any part by the individual defendants or the Ailes Estate. The settlement documents and the company's press release seem to make it clear that the $90 million settlement amount is to be funded entirely by insurance.

The apparent involvement of insurance raises the further question of what kind of insurance is funding the settlement. In that regard, it is noteworthy that the plaintiff shareholder does not allege in this lawsuit that the individual defendants themselves engaged in the alleged harassment, discrimination, or retaliation. The complaint alleges that they breached their fiduciary duties in failing to prevent the alleged misconduct. That is, the complaint does not allege employment wrongful acts of the kind that would trigger Employment Practices Liability (EPL) insurance; rather, it alleges management wrongful acts of the kind that would trigger Directors & Officers (D&O) Liability insurance. (The one exception to this generalization may be the unjust enrichment claims against the Estate of Roger Ailes; Ailes is alleged to have engaged in employment misconduct, which arguably presents its own set of issues.)

Given the current wave of sexual harassment claims, insurance related issues could become critical, including fundamental questions as to what type of insurance should be responsive.

The other thing about this settlement is its timing. As 21st Century Fox is on the sales block, it is taking care of a potentially messy piece of litigation. Further, it is coming up with a mechanism to try to show that the company has a handle on the simmering sexual misconduct allegations, to try to ensure that suitors aren't deterred by the company's past problems.

In conclusion, the outcome of this case makes it very clear that the current wave of sexual harassment revelations represents more than just a vulnerability of the bad actor individuals to having their misconduct exposed; but rather that the ongoing revelations also represents a potential liability exposure for the bad actors' companies and their executives.

ABOUT THE AUTHOR

This article was prepared by Kevin M. LaCroix, Esq. of RT ProExec. Kevin has been advising clients concerning directors' and officers' liability issues for nearly 30 years. Prior to joining RT ProExec, Kevin was President of Genesis Professional Liability Managers, a D&O liability insurance underwriter. Kevin previously was a partner in the Washington, D.C. law firm of Ross Dixon & Bell.

CONTACT

RT SPECIALTY
180 North Stetson Avenue
Suite 4600
Chicago, IL 60601
O: 312-784-6001
www.rtspecialty.com

RT ProExec