Corporate Compliance Survey

*By Paul E. McGreal**

This is the tenth survey from the Corporate Compliance Committee.[1] This survey summarizes selected legal developments regarding corporate compliance and ethics programs, which consist of an organization's code of conduct, policies, and procedures designed to achieve compliance with applicable legal regulations and internal ethical standards.[2] For an overview and introduction to the subject, as well as updates from prior years, please see the prior surveys.[3] This update assumes familiarity with the background and overview discussed there.

The developments discussed here relate to revised federal guidance under the Foreign Corrupt Practices Act; a recent federal court decision interpreting the Foreign Corrupt Practices Act; application of the attorney-client privilege to internal investigations; and caselaw developments under corporate law, federal employment discrimination law, and state employment law. Part I reviews significant developments under the anti-bribery provisions of the Foreign Corrupt Practices Act, Part II reviews recent decisions under the attorney-client privilege, and Part III reviews significant caselaw developments.

I. Foreign Corrupt Practices Act

The U.S. Foreign Corrupt Practices Act (FCPA) has two parts: the accounting provision and the anti-bribery provision. The accounting provision requires that all public companies keep accurate financial records and maintain internal controls adequate to produce such records. The anti-bribery provision, which is the

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1. This survey incorporates background and related textual discussions from prior surveys throughout the text. *See* Corporate Compliance Comm., Am. Bar Ass'n Section of Bus. Law, *Corporate Compliance Survey*, 60 Bus. Law. 1759 (2005) [hereinafter *Survey I*]; Corporate Compliance Comm., Am. Bar Ass'n Section of Bus. Law, *Corporate Compliance Survey*, 61 Bus. Law. 1645 (2006) [hereinafter *Survey II*]; Corporate Compliance Comm., Am. Bar Ass'n Section of Bus. Law, *Corporate Compliance Survey*, 63 Bus. Law. 195 (2007) [hereinafter *Survey III*]; Paul E. McGreal, *Corporate Compliance Survey*, 64 Bus. Law. 253 (2008) [hereinafter *Survey IV*]; Paul E. McGreal, *Corporate Compliance Survey*, 65 Bus. Law. 193 (2009) [hereinafter *Survey V*]; Paul E. McGreal, *Corporate Compliance Survey*, 66 Bus. Law. 125 (2010); Paul E. McGreal, *Corporate Compliance Survey*, 67 Bus. Law. 227 (2011); Paul E. McGreal, *Corporate Compliance Survey*, 68 Bus. Law. 163 (2012) [hereinafter *Survey VIII*]; Paul E. McGreal, *Corporate Compliance Survey*, 69 Bus. Law. 107 (2013).

2. While compliance programs can take an even broader view, managing all of the organization's risks, I focus here on legal compliance.

3. *See supra* note 1.

focus of this discussion, makes it a federal crime to bribe a foreign government official.[4] The anti-bribery provision applies to a wide range of actors, including companies with securities registered under federal law; companies incorporated or located in the United States; U.S. citizens, nationals, and residents; and any person or company that took action in furtherance of a prohibited bribe "while in the territory of the United States."[5] An unlawful bribe occurs when a person or entity covered under the statute uses interstate commerce to give anything of value to a foreign official with the corrupt purpose of obtaining or retaining business.[6]

Making matters more complicated, the FCPA applies when an organization directly makes the forbidden payment to a foreign government official and when that organization makes a payment to a third party (such as an agent or contractor) *knowing* that the third party will then make a forbidden payment to a foreign government official.[7] "Knowing" is defined to include circumstances where "a person is aware of a high probability of the existence of [the forbidden payment], unless the person actually believes that such circumstance does not exist."[8] Thus, a company or individual may be deemed to know of an agent's bribe if the company were "aware of a high probability" that a bribe might be made.[9] Such awareness could exist when an agent's activities raise red flags, such as a request for payment in cash or under an assumed name, a higher than usual commission, or a refusal to document expense-reimbursement requests. To avoid a finding that the organization "knew" such an agent was making bribes, the organization should implement compliance controls to prevent and detect agent misconduct.

Many terms within the anti-bribery provision are open to interpretation: What does it mean to take action "while in the territory of the United States"? What constitutes anything of value? Who is a foreign official? Because most FCPA

4. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, § 103(a), 91 Stat. 1494, 1495–96 (codified as amended at 15 U.S.C. § 78dd-1 (2006)).

5. FCPA § 105(a), 15 U.S.C. § 78dd-3(a) (2012).

6. The full text of the prohibition is as follows:

> It shall be unlawful for any issuer which has a class of securities registered pursuant to section 78*l* of this title or which is required to file reports under section 78o(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to—
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> (1) any foreign official for purposes of—
>
> (A)(i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or
>
> (B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality . . . .

FCPA § 103(a), 15 U.S.C. § 78dd-1(a)(1).

7. FCPA § 103(a), 15 U.S.C. § 78dd-1(a)(3).

8. 15 U.S.C. § 78dd-1(f)(2)(B).

9. *Id.*

investigations settle, there are few decided cases interpreting these terms.[10] Therefore, the government's interpretation takes on added significance; that is, because settlement with the government is almost certain, compliance professionals want to know what kinds of behavior are likely to trigger an investigation by the U.S. Department of Justice (DOJ) or the U.S. Securities and Exchange Commission (SEC). This will inform the design and implementation of the company's compliance program, such as its FCPA policy, training, monitoring, and auditing. Until recently, the DOJ's only written guidance directed to the FCPA was a rather slim document that added little gloss to the statute's text and provided no enforcement or compliance guidance.[11] This left to compliance professionals the task of reviewing a wide array of sources to decipher the government's likely disposition, including deferred prosecution agreements, speeches, press releases, opinion procedure releases,[12] and the like.

Not surprisingly, compliance professionals were greatly encouraged by the November 2012 release of a document titled *A Resource Guide for the U.S. Foreign Corrupt Practices Act*.[13] At 120 pages, including footnotes, the document more than lived up to its name, and it instantly became a must-read for compliance professionals facing FCPA issues. While the *Resource Guide* broke no new ground on either the government's interpretation or enforcement priorities under the FCPA, it did the tremendous service of collecting a wide array of FCPA sources into a single document. Furthermore, the selection of sources provides some insight into the DOJ's and SEC's current thinking on FCPA interpretation and enforcement. Given its scope and relative detail, the *Resource Guide* quickly became an essential volume on the compliance and ethics officer's bookshelf.

A recent criticism of the *Resource Guide* is that revisions over the last three years have been "opaque, making it difficult to know whether and when changes have been made."[14] For example, a comparison of various versions of the *Resource Guide* shows that in around December 2012, the DOJ and SEC revised

10. The government's first FCPA trial against a corporation was not until 2011, which resulted in a jury verdict of guilty. *See* Press Release, U.S. Dep't of Justice, California Company, Its Two Executives and Intermediary Convicted by Federal Jury in Los Angeles on All Counts for Their Involvement in Scheme to Bribe Officials at State-Owned Electrical Utility in Mexico (May 11, 2011) (No. 11-596), http://www.justice.gov/opa/pr/2011/May/11-crm-596.html. The conviction was later overturned by the trial court judge. U.S. v. Aguilar, 831 F. Supp. 2d 1180 (C.D. Cal. 2011).

11. U.S. Dep't of Justice & U.S. Dep't of Commerce, Foreign Corrupt Practices Act: Antibribery Provisions (2011).

12. The FCPA charges the DOJ with responding to requests for guidance regarding application of the FCPA to specific transactions. *See* Foreign Corrupt Practices Act Amendments of 1988 § 5003(a), 15 U.S.C. §§ 78dd-1, 78dd-2 (2012). Also, the DOJ has promulgated rules governing such requests, which are answered in a document known as an "opinion procedure release." *See* Foreign Corrupt Practices Act Opinion Procedure, 28 C.F.R. §§ 80.1–80.16 (2015). The DOJ collects these opinion procedure releases on its web page. *See Foreign Corrupt Practices Act: Opinion Procedure Releases*, U.S. Dep't of Justice, http://www.justice.gov/criminal/fraud/fcpa/opinion/ (last visited Sept. 28, 2015).

13. Criminal Div., U.S. Dep't of Justice & Enforcement Div., U.S. Sec. & Exch. Comm'n, A Resource Guide to the U.S. Foreign Corrupt Practices Act (2012), *available at* http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.

14. Marc Alain Bohn, *A Closer Look at the Revisions to the FCPA Guide*, FCPA Blog (Aug. 6, 2015, 7:05 PM), http://www.fcpablog.com/blog/2015/8/6/a-closer-look-at-the-revisions-to-the-fcpa-guide.html#sthash.SjBYGwDZ.dpuf.

the substantive discussion of joint ventures to correct errors. Sometime later, with one commentator dating the change between April 2013 and April 2014, the text of the *Resource Guide* was revised concerning the available fine ranges.[15] Neither change was announced by the DOJ or the SEC, nor does the text of the *Resource Guide* indicate that any changes were made from the original document. Indeed, the only indication that the document posted online may be different from the original version appears in the web address for the PDF file, which includes the date "2015/01/16."[16] In light of this inconsistent practice, the following advice from an FCPA commentator is well taken: "[P]ractitioners relying on the FCPA Guide would be wise to consult the current online version of the guidance posted to the DOJ's and SEC's respective websites."[17]

In a rare judicial development, the U.S. Court of Appeals interpreted the Act's use of the term "foreign official." The statute defines the term to include employees of "a foreign government or any department, agency, or *instrumentality thereof*."[18] In *United States v. Esquenazi*,[19] the United States prosecuted two executives for using agents to make allegedly improper payments to employees of Telecommunications D'Haiti S.A. (Haiti Teleco), the state-owned national telecommunications entity of Haiti. The payments were made allegedly to gain the business advantage of "reduced international telecommunications rates and unearned credits."[20]

The Eleventh Circuit brief for the United States explains the factual background for the argument that Haiti Teleco was a government instrumentality:

> During the relevant time period, Teleco was controlled by its Board of Directors and General Director, and those individuals were appointed through an executive order issued by the President of Haiti and signed by Haiti's Prime Minister, the Minister of Public Works, Transportation and Communications, and the Minister of Economy and Finance. At least three of the five board members were public officials, including the Board's president and vice-president. In March 2001, President Jean-Bertrand Aristide appointed Patrick Joseph as General Manager of Teleco, and in June 2003, the Minister of Public Works appointed Duperval as Teleco's Deputy General Director and set his salary.
>
> Haitian law recognized Teleco as a state-owned company. In 1996, Haiti passed a "modernization law" to partially privatize "public institutions" that were "not well managed by . . . [the] government" and "were losing money." One of the law's provisions specifically named "telephones" as a "State-owned compan[y]."

15. *Id.*
16. The full web address is http://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.
17. Bohn, *supra* note 14.
18. FCPA § 103(f)(2), 15 U.S.C. § 78dd-1(f)(2) (2012) (emphasis added).
19. 752 F.3d 912 (11th Cir. 2014).
20. Corrected Brief of Appellant at 7, United States v. Esquenazi, 752 F.3d 912 (11th Cir. 2014) (No. 11-15331-C) [hereinafter Appellant's Brief].

> Teleco also enjoyed the benefits of a state-owned corporation. It did not pay corporate income tax or custom duties, and the bank paid its expenses and covered its losses when it failed to realize any profits. If Teleco had been profitable, Haitian law dictated that the profits would have been distributed to the public treasury and the bank's reserve funds.[21]

The government relied on a multifactor test to argue that the entity performs a governmental function. These factors include government ownership of and subsidy to the entity, appointment of the entity's management and board by the government, how the entity is treated by the country's domestic laws, and whether the entity carries out a purpose or function of the government.[22] Esquenazi countered that government instrumentality should be limited to entities that perform traditional governmental functions akin to a "political subdivision."[23] He argued that Haiti Teleco operated as a private telecommunications company and not as a traditional government department or agency.[24]

In May 2014, the Eleventh Circuit sided with the government's more expansive definition.[25] The court focused on how the foreign government viewed the entity at issue:

> [T]o decide in a given case whether a foreign entity to which a domestic concern makes a payment is an instrumentality of that foreign government, we ought to look to whether that foreign government considers the entity to be performing a governmental function. And the most objective way to make that decision is to examine the foreign sovereign's actions, namely, whether it treats the function the foreign entity performs as its own. Presumably, governments that mutually agree to quell bribes flowing between nations intend to prevent distortion of the business they conduct on behalf of their people. We ought to respect a foreign sovereign's definition of what that business is.[26]

Based on this interpretation, the court adopted a test with two elements: government control of the entity at issue and the government's treatment of the work performed by the entity. An instrumentality, then, is "an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own."[27] The court adopted this test as more consistent with the FCPA's text and history, including amendments to the FCPA to conform the statute to the United States' obligations under the Anti-Bribery Convention of the Organization for Economic Cooperation and Development. Further, the court rejected the defendant's proposed "traditional government function" test as unworkable. For one, the list of activities considered government "functions" changes over time; therefore, it would be inappropriate to define an instrumen-

21. Brief of the United States at 7, United States v. Esquenazi, 752 F.3d 912 (11th Cir. 2014) (No. 11-15331-C).
22. *Id.* at 29–31.
23. Appellant's Brief, *supra* note 20, at 29, 32.
24. Appellant's Brief, *supra* note 20, at 45, 48.
25. United States v. Esquenazi, 752 F.3d 912 (11th Cir. 2014).
26. *Id.* at 924–25.
27. *Id.* at 925.

tality by a traditional conception tied to past practices.[28] In addition, what constitutes "government functions" differs from country to country, and "the most objective way to make that decision is to examine the foreign sovereign's actions, namely, whether it treats the function the foreign entity performs as its own."[29]

The court's opinion explained that its two-prong test is heavily "fact-bound," and then it offered a list of nonexhaustive factors for each.[30] On the question of government control, the court provided the following guidance:

> To decide if the government "controls" an entity, courts and juries should look to the foreign government's formal designation of that entity; whether the government has a majority interest in the entity; the government's ability to hire and fire the entity's principals; the extent to which the entity's profits, if any, go directly into the governmental fisc, and, by the same token, the extent to which the government funds the entity if it fails to break even; and the length of time these indicia have existed.[31]

On the question of how the government treats the entity's work, the court provided the following factors:

> Courts and juries should examine whether the entity has a monopoly over the function it exists to carry out; whether the government subsidizes the costs associated with the entity providing services; whether the entity provides services to the public at large in the foreign country; and whether the public and the government of that foreign country generally perceive the entity to be performing a governmental function.[32]

The court concluded that the trial court's jury instruction had adequately covered both prongs of the instrumentality test and that Haiti Teleco easily met both prongs.[33]

II. Attorney-Client Privilege

Over the last two years, Judge James Gwin of the U.S. District Court for the District of Columbia has been in an extraordinary exchange with the U.S. Court of Appeals for the D.C. Circuit over application of the attorney-client privilege to a company's internal investigation. The litigation involves a Federal Claims Act lawsuit brought by Henry Barko, who had worked in Iraq as a contract administrator for Kellogg Brown and Root, Inc. (KBR). Barko claimed that KBR had defrauded the U.S. government by submitting false charges for services performed in Iraq. Upon learning of the possible wrongdoing, KBR conducted

28. *Id.* at 924.
29. *Id.* at 925.
30. *Id.* ("It would be unwise and likely impossible to exhaustively answer them in the abstract. Because we only have this case before us, we do not purport to list all of the factors that might prove relevant to deciding whether an entity is an instrumentality of a foreign government. For today, we provide a list of some factors that may be relevant to deciding the issue.").
31. *Id.*
32. *Id.* at 296.
33. *Id.* at 927–29.

an internal investigation as required by its business code of conduct; the code itself was required by Department of Defense regulations applicable to all defense contractors.[34] In a request for production of documents, Barko asked for "documents relating to internal audits and investigations of the subject matter of the" litigation.[35] KBR asserted the attorney-client privilege to protect its internal investigation from discovery, and Barko filed a motion to compel production.

The district court found that the attorney-client privilege did not protect the internal investigation and ordered production of the requested documents. The court explained that the privilege only protects communications made with the "primary purpose" "of securing . . . either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding."[36] The court further explained that a primary purpose must be a "but for" cause.[37] In this case, because KBR's code required an internal investigation, legal advice could not be the "but for" cause of the investigation, and the documents were not privileged. The court ordered production.

The district court's decision effectively deprived an organization with an effective compliance and ethics program of the attorney-client privilege for an internal investigation. The Sentencing Guidelines provide that "[a]fter criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct."[38] One critical step in responding "appropriately" is to investigate the wrongdoing that has been detected; moreover, an effective compliance and ethics program will mandate a thorough internal investigation. Because of this mandate, obtaining legal advice would not be the "but for" cause of an internal investigation, and the attorney-client privilege could not attach.[39]

When the district court refused to certify its order for appeal and then set a quick deadline for document production, KBR filed a petition for writ of mandamus in the court of appeals. The court of appeals rejected the district court's "but for" standard, adopting instead a "significant purpose" test:

> Given the evident confusion in some cases, we also think it important to underscore that the primary purpose test, sensibly and properly applied, cannot and does not draw a rigid distinction between a legal purpose on the one hand and a business purpose on the other. After all, trying to find the one primary purpose for a communication motivated by two sometimes overlapping purposes (one legal and one business, for example) can be an inherently impossible task. It is often not useful or even feasible to try to determine whether the purpose was A or B when the pur-

34. *See* 48 C.F.R. §§ 203.7000–.7001(a) (2015).
35. United States *ex rel.* Barko v. Halliburton Co., 37 F. Supp. 3d 1, 3 (D.D.C. 2014).
36. *Id.* at 5.
37. *Id.*
38. U.S. Sentencing Guidelines Manual § 8B2.1(b)(7) (U.S. Sentencing Comm'n 2014).
39. In ruling on KBR's petition for writ of mandamus, the court of appeals reached a similar conclusion: "the District Court's novel approach would eradicate the attorney-client privilege for internal investigations conducted by businesses that are required by law to maintain compliance programs, which is now the case in a significant swath of American industry." *In re* Kellogg Brown & Root, Inc., 756 F.3d 754, 759 (D.C. Cir. 2014).

> pose was A and B. It is thus not correct for a court to presume that a communication can have only one primary purpose. It is likewise not correct for a court to try to find the one primary purpose in cases where a given communication plainly has multiple purposes. Rather, it is clearer, more precise, and more predictable to articulate the test as follows: Was obtaining or providing legal advice a primary purpose of the communication, meaning one of the significant purposes of the communication? As the Reporter's Note to the Restatement says, "In general, American decisions agree that the privilege applies if one of the significant purposes of a client in communicating with a lawyer is that of obtaining legal assistance." We agree with and adopt that formulation—"one of the significant purposes"—as an accurate and appropriate description of the primary purpose test. Sensibly and properly applied, the test boils down to whether obtaining or providing legal advice was one of the significant purposes of the attorney-client communication.[40]

The court explained that under the "significant purpose" test an internal investigation could be protected by the attorney-client privilege even if it were required by a company policy mandated by legal regulation.[41] A significant purpose of seeking legal advice is not precluded by the additional purpose of conducting a required internal investigation. Because KBR was seeking legal advice in addition to following its code, a significant purpose of the internal investigation was to provide legal advice, and thus documents related to the internal investigation were protected by the attorney-client privilege.[42]

After the court of appeals ruling, the district court took up the question of whether KBR had waived the attorney-client privilege. Specifically, the court considered whether KBR had made an implied waiver,[43] which occurs when "[t]he party asserting the privilege . . . put[s] a communication at issue through some affirmative act."[44] Here, the district court concluded that KBR had put the internal investigation at issue in the litigation through the deposition of its in-house counsel. On questioning by KBR's attorney, the in-house counsel testified that: (1) Department of Defense regulations required KBR to disclose to the government whenever it has "reasonable grounds to believe" that a legal violation has occurred; (2) KBR had made such disclosures in the past; and, (3) after an investigation of the alleged wrongdoing underlying this litigation, KBR had not made a report to the government.[45] KBR then cited this testimony in its motion for summary judgment where it repeated the assertion that it had reported wrongdoing to the government in the past when it had found reasonable grounds for doing so and that it made no report in this matter after conducting the required internal investigation.[46]

40. *Id.* at 760 (citation omitted).
41. *Id.*
42. *Id.*
43. The court also referred to implied waiver as "at issue waiver" throughout its opinion. For simplicity, I use only "implied waiver" in the text above.
44. United States *ex rel.* Barko v. Halliburton Co., 37 F. Supp. 3d 1, 9 (D.D.C. 2014).
45. *Id.* at 11–17.
46. *Id.*

The district court concluded that KBR was using the internal investigation to advocate inferences in support of summary judgment:

> KBR's message is obvious: KBR's COBC reports—which are a privileged investigation of Barko's allegations—contain no reasonable grounds to believe a kickback occurred. And KBR gives a second message: do not worry about the production of the COBC documents because they show nothing. KBR does not state this conclusion explicitly. It does not need to. KBR's statements make its preferred conclusion both unspoken and unavoidable.[47]

According to the court, KBR put the contents of the internal investigation at issue on a key question: Did the fraud occur? The district court concluded that KBR's actions by implication waived the privilege and once again ordered production of the internal investigation documents on a short timeline. KBR again filed a petition for writ of mandamus in the court of appeals, and that court stayed production of the documents.

The court of appeals again overturned the district court, this time finding no implied waiver. The court of appeals first concluded that the in-house counsel's deposition testimony did not waive the privilege.[48] The testimony simply stated facts on the record, and those facts, standing alone, did not raise or advocate an inference concerning the content of the internal investigation.[49] Consequently, any such inference would have had to come from other actions by KBR in the litigation.[50]

The court of appeals next considered whether use of the deposition testimony in KBR's motion for summary judgment constituted an implied waiver. The court of appeals rejected the district court's conclusion that KBR had offered the "unavoidable inference" that the contents of the internal investigation did not contain evidence of wrongdoing. Instead, the court of appeals read the motion as making the descriptive assertion that KBR's consistent practice was not to waive the attorney-client privilege.[51] To emphasize KBR's seriousness on this point, the motion noted that KBR had followed this practice even in cases where an internal investigation discovered wrongdoing that had to be disclosed to the government.[52] It did so despite the fact that failure to waive the privilege could lead the government to conclude that KBR had not fully cooperated with the government or adequately disclosed the wrongdoing as required by law.[53] The intended inference was that, if KBR did not waive the privilege in making disclosures despite potentially serious negative consequences, it surely did not waive the privilege in this matter when no disclosure was made.[54]

47. *Id.* at 17.
48. *In re* Kellogg Brown & Root, Inc., 796 F.3d 137, 146 (D.C. Cir. 2015).
49. *Id.* ("The deposition transcript is simply a record of what was said, not itself an argument.").
50. The court of appeals noted that a party could waive the privilege in a deposition by disclosing otherwise privileged material. *Id.* at 145–46.
51. *Id.* at 147.
52. *Id.*
53. *Id.* ("Where companies choose not to waive privilege, '[t]hey will, of course, bear the risk that their reports will not be accepted as full disclosures.'").
54. *Id.* at 148.

The court of appeals concluded that KBR's reference to the deposition and the internal investigation did not put privileged materials at issue, and therefore KBR did not by implication waive the privilege. This ruling gives an additional layer of comfort to organizations undertaking an internal investigation because it holds that mere reference to the investigation in litigation will not waive the privilege. That said, to avoid protracted litigation of the question, counsel for an organization should clearly state the purpose of any references to an internal investigation and perhaps even specifically negate any inferences that could be used to advocate a waiver.

III. Caselaw Developments

Part III reviews compliance-related caselaw developments in state corporate law,[55] federal employment discrimination law, and state employment law.[56] Section A reviews developments regarding the duty of corporate officers and directors, first discussed in *In re Caremark International Inc. Derivative Litigation*,[57] to oversee a corporation's legal compliance efforts. This discussion emphasizes the recent caselaw development of a possibly heightened oversight duty for corporate officers. Section B then reviews a recent U.S. Supreme Court case deciding the pleading standard for claims of pregnancy discrimination. Section C then discusses a state employment law case concerning the employment-at-will doctrine.

A. The *Caremark* Claim

In dicta in its 1996 decision, *In re Caremark International Inc. Derivative Litigation*, the Delaware Court of Chancery addressed the board's duty to oversee a corporation's legal compliance efforts.[58] As part of its duty to monitor, the board must make good-faith efforts to ensure that a corporation has adequate reporting and information systems.[59] The court described a claim for breach of that duty as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment,"[60] with liability attaching only for "a sustained or systematic failure of the board to exercise oversight" or "an utter failure to attempt to assure a reasonable information and reporting system exists."[61]

55. *See generally* Charles M. Elson & Christopher J. Gyves, *In re* Caremark*: Good Intentions, Unintended Consequences*, 39 Wake Forest L. Rev. 691 (2004); H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post* Caremark *Era*, 26 Del. J. Corp. L. 1 (2001).

56. *See generally* Rebecca S. Walker, *What We Can Learn About Effective Compliance Policies from Recent Employment Discrimination Cases*, Ethikos (July/Aug. 2000), http://www.ethikospublication.com/html/discrimination.html.

57. 698 A.2d 959 (Del. Ch. 1996). The inaugural survey discusses the background and compliance context of this case. *See Survey I*, *supra* note 1, at 1773–76.

58. *Caremark*, 698 A.2d at 970–71.

59. *Id.* at 967–70.

60. *Id.* at 967.

61. *Id.* at 971.

Since the decision, this Delaware dicta has morphed into what has become known as a *Caremark* claim, as federal and state courts, both within and outside Delaware, have recognized a cause of action against boards for failing to take minimal steps to achieve legal compliance.[62] As the phrases "utter failure" and "systematic failure" suggest, a board's *Caremark* duty is relatively low.[63] Only egregious lapses breach this duty, such as when board members ignore obvious red flags signaling illegal behavior,[64] fail to appoint or convene an audit committee,[65] or do not address obvious concerns such as large loans to corporate insiders.[66]

In *Stone ex rel. AmSouth Bancorporation v. Ritter*, the Delaware Supreme Court formally embraced the *Caremark* claim.[67] The court both confirmed the elements of a *Caremark* duty and clarified that breach of that duty constitutes a breach of the director's duty of loyalty:

> We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.[68]

The court in *Stone*, then, adopted the *Caremark* duty and restated it as having two components. First, there is a director's *initial duty* to address compliance and ethics.[69] The director breaches this branch of the *Caremark* duty by failing to take *any* action directed toward establishing a compliance and ethics program.[70]

Second, there is an *ongoing duty* to address compliance and ethics.[71] The director breaches this branch of the *Caremark* duty if she learns of a specific gap or weakness in the organization's compliance and ethics program but

62. For a more detailed discussion of the *Caremark* case and development of the *Caremark* claim, see Brown, *supra* note 55, at 7–32. For a critique of *Caremark*'s impact, see Elson & Gyves, *supra* note 55, at 691–706.

63. *See Caremark*, 698 A.2d at 971.

64. *See, e.g.*, McCall v. Scott, 250 F.3d 997, 999 (6th Cir. 2001); Benjamin v. Kim, No. 95 CIV. 9597 (LMM), 1999 WL 249706, at *13–14 (S.D.N.Y. Apr. 28, 1999) (quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963)).

65. *See, e.g.*, Guttman v. Huang, 823 A.2d 492, 506–07 (Del. Ch. 2003) (remarking in dicta that failure to have an audit committee would be the type of egregious failing that would support a *Caremark* claim).

66. *See, e.g.*, Pereira v. Cogan, 294 B.R. 449, 532–33 (S.D.N.Y. 2003), *vacated & remanded sub nom.* Pereira v. Farace, 413 F.3d 330 (2d Cir. 2005), *cert. denied*, 547 U.S. 1147 (2006).

67. 911 A.2d 362 (Del. 2006).

68. *Id.* at 370 (footnotes omitted).

69. *Id.*

70. *See id.*

71. *Id.*

takes no action to address that failing.[72] For example, a director may actually know of a new regulatory scheme or requirement that directly affects the business of her corporation and then fail to inquire whether the organization is taking measures to comply with the new law. Another example would be a board that charged management with implementing a compliance and ethics program never receives or requests reports on the design, implementation, and operation of the program. Note that in both of these examples the board member's failure consists of not inquiring of management; the board member need not actually design or implement the program itself. This is because the director's duty is one of oversight, and the board may rely on management in satisfying this duty.

The Delaware courts have been demanding of plaintiffs who allege breach of either component of the *Caremark* duty—the initial or ongoing duty of oversight. First, as to breach of a director's initial duty, the reported decisions require the plaintiff to plead that the director took no actions related to compliance and ethics. A prior survey discussed a case in which the plaintiff adequately pleaded that the directors consciously did *nothing* to prevent legal wrongdoing.[73] In that case, the directors were described as "stooges" for the corporation's president, who was looting the corporation of its assets.[74] Because the directors did nothing at all—they never even met—the inference of conscious disregard was inescapable.[75] Indeed, given that the directors were "stooges," it is possible they did not know a duty of oversight existed.[76] The court's decision implies, then, that conscious disregard does not require that the director was specifically aware of her *Caremark* duty. Of course, this makes sense; directors should not be rewarded for ignorance of the fiduciary duties they have voluntarily undertaken.

The pleading standard is also quite rigorous when a plaintiff alleges breach of the ongoing duty to oversee compliance and ethics. In those cases, the Delaware courts have confirmed the high threshold for pleading a director's *Caremark* liability: the plaintiffs must plead specific facts that show the director knowingly disregarded his ongoing duty to oversee the organization's compliance and ethics program.[77] The courts in these same cases have consistently held that a plaintiff will *not* meet this burden by simply pleading that the organization committed egregious or widespread wrongdoing; thus, the director *must have* known about and ignored the legal problem.[78] In short, the degree or scope of wrong-

72. *See id.*

73. *See Survey III*, *supra* note 1, at 212–13.

74. ATR-Kim Eng Fin. Corp. v. Araneta, No. 489-N, 2006 WL 3783520, at *1, *19 (Del. Ch. Dec. 21, 2006).

75. *See id.* at *21.

76. For examples of the directors' actions that led the court to identify them as "stooges," see *id.* at *20–21.

77. *Survey V*, *supra* note 1, at 207.

78. *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 373 (Del. 2006) ("The lacuna in the plaintiffs' argument is a failure to recognize that the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both . . . ."); Desimone v. Barrows, 924 A.2d 908, 940 (Del. Ch. 2007) ("Delaware courts routinely reject the conclusory allegation that because illegal behavior occurred, internal controls must have been deficient, and the board must have

doing when standing alone, however severe, will not give rise to an inference that the director was conscious of the organization's legal problems. Instead, the plaintiff must allege facts showing that the director actually knew of the wrongdoing or utterly failed to address potential wrongdoing.

A prior survey highlighted a potential for the *Caremark* duty to impose more stringent obligations on compliance officers than those shouldered by directors.[79] In *Gantler v. Stephens*, the Delaware Supreme Court held that "the fiduciary duties of officers are the same as those of directors."[80] As these duties include the "fiduciary duties of care and loyalty," and the *Caremark* duty of oversight is part of the duty of loyalty, *Gantler* meant that corporate officers owe the *Caremark* duty of oversight.[81] This holding, however, left two difficult questions for future development. First, which corporate officers owe the *Caremark* duty? And second, what specifically does the *Caremark* duty require of officers, as opposed to directors?

While acknowledging a distinction between officers and mere agents and employees,[82] the Delaware courts have not clearly identified the dividing line. And while Delaware's General Corporation Law addresses appointment of officers,[83] that law does not identify which corporate agents owe parallel fiduciary duties to directors. In lieu of such a definition, here is the definition of "officer" from section 1.27 of the American Law Institute Principles of Corporate Governance (ALI Principles):

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known so."); Guttman v. Huang, 823 A.2d 492, 506–07 (Del. Ch. 2003) ("Their conclusory complaint is empty of the kind of fact pleading that is critical to a *Caremark* claim, such as contentions that . . . the audit committee had clear notice of serious accounting irregularities and simply chose to ignore them or, even worse, to encourage their continuation."); Morefield v. Bailey, 959 F. Supp. 2d 887, 906 (E.D. Va. 2013) ("The existence of deficiencies in the internal audit practice does not equate to the Board members being conscious of a failure to do their jobs."); Kococinski v. Collins, 939 F. Supp. 2d 909, 924 (D. Minn. 2013) (shareholder's "presentation of . . . red flags falls short of pleading particularized facts supporting an inference that the outside directors actually knew the financial reports were false and misleading").

79. Survey V, *supra* note 1, at 211–14. The following background discussion of the *Gantler* and the *Caremark* duties of corporate officers incorporates text from this prior survey.

80. Gantler v. Stephens, 965 A.2d 695, 709 (Del. 2009).

81. *Id.*

82. *See* Goldman v. Shahmoon, 208 A.2d 492, 493 (Del. Ch. 1965) ("[T]here appears to be a historically rigid view of the attributes which set a corporate officer apart from an employee.").

83. Section 142 of Delaware's General Corporation Law provides in relevant part:

> (a) Every corporation organized under this chapter shall have such officers with such titles and duties as shall be stated in the bylaws or in a resolution of the board of directors which is not inconsistent with the bylaws and as may be necessary to enable it to sign instruments and stock certificates which comply with §§ 103(a)(2) and 158 of this title. One of the officers shall have the duty to record the proceedings of the meetings of the stockholders and directors in a book to be kept for that purpose. Any number of offices may be held by the same person unless the certificate of incorporation or bylaws otherwise provide.
>
> (b) Officers shall be chosen in such manner and shall hold their offices for such terms as are prescribed by the bylaws or determined by the board of directors or other governing body. Each officer shall hold office until such officer's successor is elected and qualified or until such officer's earlier resignation or removal. Any officer may resign at any time upon written notice to the corporation.

DEL. CODE ANN. tit. 8, § 142(a)–(b) (2013).

> "Officer" means (a) the chief executive, operating, financial, legal, and accounting officers of a corporation; (b) to the extent not encompassed by the foregoing, the chairman of the board of directors (unless the chairman neither performs a policy-making function other than as a director nor receives a material amount of compensation in excess of director's fees), president, treasurer, and secretary, and a vice-president or vice-chairman who is in charge of a principal business unit, division, or function (such as sales, administration, or finance) or performs a major policy-making function for the corporation; and (c) any other individual designated by the corporation as an officer.[84]

While the ALI Principles extend the duty of care to all officers,[85] the duty of loyalty extends only to "senior executives,"[86] who are defined in (a) and (b) above.[87] For purposes of analysis, we will assume that the *Caremark* duty will be limited to the first two classes of officers. Of course, if that duty is extended to category (c), the analysis would be straightforward—did the corporation designate the compliance and ethics professional at issue as an officer?

Category (a) includes the chief compliance and ethics officer who holds a second title, such as general counsel.[88] The only question that might arise is whether different duties are attached to different titles. Given the connection between legal compliance and the general counsel's role as legal adviser, however, the general counsel already owes a *Caremark* duty. Addition of the title chief compliance and ethics officer would only reinforce that conclusion.

If the chief compliance and ethics officer does not serve in a dual role, the officer would have to fall within the provision in category (b) for "a vice-president or vice-chairman who is in charge of a principal business unit, division, or function (such as sales, administration, or finance) or performs a major policymaking function for the corporation."[89] If the chief compliance and ethics officer is designated as a vice-president or vice-chairman, the issue will be whether that person (1) "is in charge of a principal business . . . function" or (2) "performs a major policymaking function."[90] Consider each in turn.

When compared to the listed functions of "sales, administration, or finance," the compliance and ethics function should be considered a "principal business . . . function."[91] First, as discussed in prior surveys, both state and federal government guidance and regulation emphasize the important role of an organization's internal compliance and ethics program.[92] Tending to this critical aspect of an organization's business should be a principal function.

84. Am. Law Inst., Principles of Corporate Governance § 1.27 (1994) [hereinafter ALI Principles].
85. *Id.* § 4.01.
86. *Id.* § 5.01. The ALI Principles refer to the duty of loyalty as the duty of fair dealing. *See id.* pt. V (duty of fair dealing).
87. *Id.* § 1.27.
88. *See id.*
89. *Id.*
90. *Id.*
91. *See id.*
92. *Survey I*, *supra* note 1, at 1780–95; *Survey II*, *supra* note 1, at 1650–57; *Survey III*, *supra* note 1, at 197–209; *Survey IV*, *supra* note 1, at 271–74.

Second, responsibility for the compliance and ethics program is comparable to two other functions listed at the officer level: legal and finance. On the one hand, compliance and ethics programs are charged with ensuring compliance with the organization's *legal* obligations, which American Bar Association guidance places within the scope of the chief legal officer's responsibilities.[93] On the other hand, compliance and ethics programs design and implement internal controls to track corporate behavior, which is akin to the internal controls overseen by finance. Thus, compliance and ethics can be seen as a business function at the crossroads of the finance and legal functions.

The chief compliance and ethics officer could also be an officer charged with "a major policymaking function for the corporation."[94] The comments to the ALI Principles elaborate on this provision:

> The "major policymaking" test in Subsection (b) is intended to be applied to the corporation's business as a whole. Therefore, a vice-president who has policymaking functions in connection with only a unit or division would not fall within Subsection (b) for that reason alone, unless that unit or division represents a substantial part of the total business. A staff member who gives advice on policy but does not have authority, alone or in combination with others, to make policy, does not perform a major policymaking function within the meaning of Subsection (b).[95]

This comment raises two aspects of the "major policymaking function": scope of responsibility and degree of authority. If an organization follows the Federal Sentencing Guidelines, the chief compliance and ethics officer should meet both criteria.[96] First, the guidelines require that "[s]pecific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program."[97] The person who is delegated "overall responsibility" for the organization's compliance and ethics program will necessarily have the broad, entity-wide scope of authority contemplated by the ALI Principles. Second, the guidelines provide that compliance and ethics officers "shall be given

93. Report of the American Bar Association Task Force on Corporate Responsibility 20–23 (Mar. 31, 2003), *available at* http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf.

94. *See* ALI Principles, *supra* note 84, § 1.27.

95. *Id* § 1.27 cmt. c. The comment continues with a reference to the federal securities laws:

> Corporations filing a Form 10-K under the Securities Exchange Act must determine the identity of their executive officers under Item 401 of Regulation S-K. Corporations subject to the SEC's Proxy Rules must also identify each of their executive officers in the annual report accompanying the proxy statement for the annual meeting. Rule 14a-3(b)(8). It is intended that in the case of such corporations, the group of officers falling within Subsection (b) would be no wider (and, with the possible exception of the four specifically designated officers, would normally be narrower) than the group of executive officers that are presently contemplated by Form 10-K and the Proxy Rules.

Id. If companies list the chief compliance and ethics officer as an executive officer in the above filings, that would arguably require treating the chief compliance and ethics officer as an officer for fiduciary duty purposes. *See, e.g.*, Baker Hughes Inc., Form 10-K, at 13 (Feb. 27, 2009) (listing the positions of vice-president, chief compliance officer, and senior deputy counsel among the company's executive officers).

96. *See* U.S. Sentencing Guidelines Manual § 8B2.1(b)(2) (U.S. Sentencing Comm'n 2014).

97. *Id.* § 8B2.1(b)(2)(B).

adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority."[98] Again, meeting the Federal Sentencing Guidelines should also meet the ALI Principles. The more difficult question will be which compliance personnel beyond the chief compliance officer, if any, fall within the ALI Principles.[99]

The answer to the next question, "What does the *Caremark* duty require of compliance personnel who are deemed corporate officers?" is much less clear. As noted above, the Delaware Supreme Court has framed the *Caremark* duty as follows: "(a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[100] The question is how these twin duties, phrased in terms of *directors*, apply to compliance and ethics *officers*. Consider the standard that a board member not "utterly fail[] to implement any reporting or information system or controls." It makes sense to put the director's duty at this high a level because the board oversees the corporation, leaving day-to-day operations to management. Further, the board may rely on the reporting and work of management in discharging its duty of oversight.[101] Conversely, the officers charged with day-to-day operations may owe a more precisely defined *Caremark* duty. For example, one could frame breach of the chief compliance and ethics officer's initial *Caremark* duty as an utter failure to take steps to implement any one of the components of a compliance and ethics program—i.e., risk assessment, policies, training, monitoring, auditing, or discipline. Under this view, the board's duty is to get the compliance ball rolling, and the chief compliance and ethics officer's duty is to keep that ball moving in the right direction.

The second component of the *Caremark* duty will be more difficult to define. Recall that the second *Caremark* branch, the ongoing duty, imposes liability on a fiduciary who "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[102] A director likely satisfies this duty simply by receiving and reviewing reports in connection with periodic board meetings or by inquiring of management after learning of compliance red flags.[103] This duty, however, likely requires more of a chief compliance and ethics officer charged with overall respon-

98. *Id.* § 8B2.1(b)(2)(C).

99. As noted above, the comments to section 1.27 refer to federal securities law filings in their definition of "officer." ALI PRINCIPLES, *supra* note 84, § 1.27 cmt. c. To the extent that companies do not list other compliance personnel as executive officers in these filings, the comments suggest that the definition of "officer" does not reach those personnel. *See id.*

100. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

101. DEL. CODE ANN. tit. 8, § 141(e) (2013) ("A member of the board of directors . . . shall, in the performance of such member's duties, be fully protected in relying in good faith upon . . . such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees . . . .").

102. *Stone*, 911 A.2d at 370.

103. *See supra* note 9 and accompanying text (discussing the red flags identified by the DOJ).

sibility for the organization's compliance and ethics program. In that role, the chief compliance and ethics officer will be continuously updated regarding operation of the compliance and ethics program and should therefore be familiar with the program's ongoing strengths and weaknesses. Also, that role will place many more matters within the scope of "risks or problems requiring . . . attention."[104] Whereas the board may engage with compliance only periodically, the chief compliance and ethics officer must do so continuously.

The chief compliance and ethics officer's enhanced *Caremark* duty poses a potential trap for such officers who are overworked or whose departments are understaffed. For example, consider the chief compliance and ethics officer who performs a dual role—e.g., the combined chief compliance and ethics officer and general counsel. If this officer's department is understaffed, she cannot possibly perform all the assigned duties, and oversight of the compliance and ethics program will likely suffer. This is because compliance and ethics work is largely preventive and compliance omissions often have few immediate observable consequences. Conversely, the general counsel often responds to current or periodic needs and crises, which is work that may demand constant attention. An overworked chief compliance and ethics officer may now be set up for a *Caremark* claim; the compliance and ethics program generates continuous feedback to a chief compliance and ethics officer who cannot adequately address all the information that the feedback offers. And if a critical compliance issue falls through the cracks, a plaintiff's attorney may argue that the chief compliance and ethics officer consciously disregarded that risk. After all, mere receipt of compliance and ethics information may raise an inference that the chief compliance and ethics officer was aware of that information. To avoid this problem, it is critical for chief compliance and ethics officers to secure the necessary time and resources to succeed in their role.

Two cases from the last year involved *Caremark* claims against corporate officers. The first case, *In re Galena Biopharma, Inc. Derivative Litigation*,[105] is curious for its failure to acknowledge the issue. There, the plaintiffs had alleged that both directors and officers had breached their duty to oversee internal controls needed to ensure preparation of accurate financial statements. Concerning the claim against corporate officers, the court made the following statement: "Plaintiffs cite to no case holding that non-director officers can be liable for failing to maintain internal company controls, and Plaintiffs do not explain the basis for asserting this claim against Defendants Dunlap and Schwartz, who are alleged to be non-director officers." This statement is true enough: the plaintiffs' response to the defendants' motion to dismiss does not separately discuss officer liability under *Caremark*, and it does not cite *Gantler* for the proposition that officers owe the same fiduciary duties as directors.[106] The defendants' filings on

104. *See Stone*, 911 A.2d at 370.

105. 83 F. Supp. 3d 1047 (D. Or. 2015).

106. Plaintiffs' Response in Opposition to Defendants' Motion to Dismiss Plaintiffs' Verified Amended Consolidated Shareholder Derivative Complaint and Defendant Mark J. Ahn's Motion to Dismiss at 23–25, *In re* Galena Biopharma Inc. Derivative Litig., Nos. 3:14-cv-00382-SI LEAD, 3:14-cv-514-SI, 3:14-cv-516-SI, 83 F. Supp. 3d 1047 (D. Or. 2015), 2014 WL 7273836.

the motion to dismiss, however, did not argue that the *Caremark* duty does not apply to corporate officers.[107] Thus, the district court appears to have raised this distinction on its own. If so, it is not clear why the court did not discover the *Gantler* case or other writings on officer fiduciary duties. Regardless, the statement that there is no basis for officer *Caremark* liability is clear error and should be reversed on appeal. The question would remain whether the facts alleged would satisfy any applicable pleading standard for such officer liability.

A federal district court discussed, but did not decide, the issue of an officer's *Caremark* duty in *Iron Workers Mid-South Pension Fund v. Davis*.[108] The case involved a claim that directors and officers of U.S. Bancorp breached their duty to oversee internal controls that would have prevented wrongdoing related to transactions involving mortgage-backed securities. The court dismissed the *Caremark* claim against the directors for failure to plead facts that showed that they had consciously disregarded weaknesses in the company's internal controls.[109] The plaintiffs' alleged red flags, such as the directors' alleged knowledge that lenders were experiencing problems with delinquencies on residential mortgages, were too general to support an inference of knowledge of problems at U.S. Bancorp.[110] This decision is an unremarkable application of the stringent pleading standard for *Caremark* claims against directors.

When the court turned to the *Caremark* claim against officers, it noted that the plaintiffs invoked the fiduciary duty of care in addition to the duty of loyalty. The court explained that this distinction matters because the duty of loyalty imposes the familiar "conscious disregard" standard, while the duty of care may hold plaintiffs to a less stringent "gross negligence" standard:

> Insofar as Iron is bringing an independent claim for a violation of the duty of care on factual allegations very similar to those constituting its breach of the duty of loyalty claim, Iron argues that the duty of care claim is subject to a lower standard of review than a duty of loyalty claim. Specifically, Iron maintains that "duty of care violations are actionable only if the directors acted with gross negligence." Courts are divided on the question of whether an officer may be liable for a breach of the duty of care under the standard of gross negligence or the higher standard of bad faith or conscious disregard.[111]

The court left this question for another day, deciding that even if "gross negligence" is the proper standard, the plaintiffs' allegations did not meet even that lower pleading standard.[112]

107. *See* Motion to Dismiss Plaintiffs' Verified Amended Consolidated Shareholder Derivative Complaint at 19–21, *In re* Galena Biopharma Inc. Derivative Litig., Nos. 3:14-cv-00382-SI LEAD, 3:14-cv-514-SI, 3:14-cv-516-SI, 83 F. Supp. 3d 1047 (D. Or. 2015), 2014 WL 6480477.

108. Civil No. 13-289, 2015 WL 1275338 (D. Minn. Mar. 19, 2015).

109. *Id.* at *8–*9.

110. *Id.*

111. *Id.* at *10 (citations omitted).

112. *Id.* at *11 ("The Court will assume without deciding that the proper standard for evaluating an officer's duty of care is gross negligence.").

In applying the gross negligence standard to the plaintiffs' allegations, the court quoted a definition from Delaware case law: "[P]leading [gross negligence] successfully in a case like this requires the articulation of facts that suggest a wide disparity between the process the directors used to ensure the integrity of the company's financial statements and that which would have been rational."[113] The court gave great weight to the "wide disparity" language, faulting the plaintiffs' complaint because it did not "articulate what would have been rational or reasonable on the part of the officer defendants" and did "not explain what actions the officer defendants should have reasonably taken in light of the alleged red flags."[114]

Under this definition of "gross negligence," the question going forward is what plaintiffs must plead to show a "rational or reasonable" alternative course of conduct. For compliance officers, one way to satisfy this pleading standard could be to refer to the growing body of writing on best practices in corporate compliance. Indeed, the purpose of compliance and ethics best practices and other recommendations is to guide actions by compliance officers, so such material should be probative of what is "rational and reasonable" conduct for such an officer. This could prove a double-edged sword for compliance and ethics officers. On the one hand, following best practices could protect compliance and ethics officers, allowing them to show that no "wide disparity" exists between their conduct and what is "rational and reasonable." On the other hand, failure to follow best practices, especially when those practices are contested or unclear, could leave a compliance and ethics officer vulnerable to the inference that a "wide disparity" exists. It will take future caselaw development to flesh out this emerging standard of officer liability.

B. Pregnancy Discrimination

In *Young v. United Parcel Service, Inc.*,[115] the U.S. Supreme Court decided the pleading standard for claims under the Pregnancy Discrimination Act.[116] The case involved a pregnant female employee of United Parcel Service (UPS) who worked as a part-time driver. UPS required drivers to be able to lift seventy or more pounds, and the female driver was told by her doctor not to lift more than twenty pounds. The female driver requested that UPS accommodate her lifting restriction by assigning her to other work assignments within the company. Under its collective bargaining agreement, UPS accommodated other employees who were unable to drive or lift packages, such as employees injured on the job or who had lost their driving certification with the U.S. Department of Transportation. UPS, however, did not have a policy to accommodate pregnant employees, and so the female driver was put on unpaid leave. The female driver filed a lawsuit in federal court claiming that the failure to accommodate her pregnancy-related lifting restriction violated the Pregnancy Discrimination Act.

113. *Id.* (quoting Guttman v. Huang, 823 A.2d 492, 507 n.39 (Del. Ch. 2003)).
114. *Id.*
115. 135 S. Ct. 1338 (2015).
116. *See* 42 U.S.C. § 2000e(k) (2012).

In the lower courts, UPS argued that it had a neutral policy that did not discriminate against pregnant female employees.[117] The company noted that it did not accommodate any employees whose physical limitations arose from outside the workplace and were not covered by the Americans with Disabilities Act.[118] Because the female driver's lifting restriction was neither an on-the-job injury nor a disability covered by the ADA, UPS's neutral policy did not require an accommodation. The female driver countered that UPS had discriminated because it accommodated some employees with similar lifting restrictions (i.e., those with on-the-job-injuries) but not pregnant employees.[119] She argued that this different treatment should violate the Pregnancy Discrimination Act.[120] Both lower courts found for UPS, and the female driver appealed to the Supreme Court.[121]

The Court took an intermediate approach between the arguments advocated by UPS and the female driver, adopting the burden-shifting test from *McDonnell Douglas Corp. v. Green*,[122] which governs gender discrimination claims under Title VII. The following passage describes how that framework applies to a claim of pregnancy discrimination:

> [A] plaintiff alleging that the denial of an accommodation constituted disparate treatment under the Pregnancy Discrimination Act's second clause may make out a prima facie case by showing, as in *McDonnell Douglas*, that she belongs to the protected class, that she sought accommodation, that the employer did not accommodate her, and that the employer did accommodate others "similar in their ability or inability to work."
>
> The employer may then seek to justify its refusal to accommodate the plaintiff by relying on "legitimate, nondiscriminatory" reasons for denying her accommodation. But, consistent with the Act's basic objective, that reason normally cannot consist simply of a claim that it is more expensive or less convenient to add pregnant women to the category of those ("similar in their ability or inability to work") whom the employer accommodates. . . .
>
> If the employer offers an apparently "legitimate, non-discriminatory" reason for its actions, the plaintiff may in turn show that the employer's proffered reasons are in fact pretextual. We believe that the plaintiff may reach a jury on this issue by providing sufficient evidence that the employer's policies impose a significant burden on pregnant workers, and that the employer's "legitimate, nondiscriminatory" reasons are not sufficiently strong to justify the burden, but rather—when considered along with the burden imposed—give rise to an inference of intentional discrimination.
>
> The plaintiff can create a genuine issue of material fact as to whether a significant burden exists by providing evidence that the employer accommodates a large per-

117. *Young*, 135 S. Ct. at 1347–48.
118. The Court noted that the ADA had since been amended to clarify that temporary lifting restrictions can qualify as a covered disability. *Id.* at 1348.
119. *Id.* at 1347.
120. *Id.*
121. *Id.* at 1347–48.
122. 411 U.S. 792 (1973).

> centage of nonpregnant workers while failing to accommodate a large percentage of pregnant workers. Here, for example, if the facts are as Young says they are, she can show that UPS accommodates most nonpregnant employees with lifting limitations while categorically failing to accommodate pregnant employees with lifting limitations. Young might also add that the fact that UPS has multiple policies that accommodate nonpregnant employees with lifting restrictions suggests that its reasons for failing to accommodate pregnant employees with lifting restrictions are not sufficiently strong—to the point that a jury could find that its reasons for failing to accommodate pregnant employees give rise to an inference of intentional discrimination.[123]

The Court sent the case back to the lower courts to determine whether Young had met this revised pleading standard.

The burden-shifting test adopted in *Young* holds important lessons for employers as they consider policies and practices for accommodating employees with physical limitations. Once an employer accommodates one or more classes of employees with a physical limitation, it must decide whether to accommodate pregnant employees with a similar physical limitation. To ignore this issue is to leave the company open to the inference of a "substantial burden" because some employees are accommodated while pregnant employees are not. Also, if an employer decides not to accommodate pregnant employees with physical limitations, it should specifically identify and document the "legitimate, nondiscriminatory" reason for doing and steer clear of the specifically forbidden reasons that it would be "more expensive or less convenient to do so."

C. Wrongful Discharge of Chief Compliance Officer

A compliance officer often occupies a vulnerable position within an organization. Charged with the responsibility for preventing and detecting legal wrongdoing, a compliance officer might discover wrongdoing by senior management, which could make the compliance officer a target of retaliation. One might reasonably question whether a compliance officer can adequately withstand these pressures if she is only an at-will employee. That question was in the background when the New York Court of Appeals decided whether it should recognize a common law claim of retaliatory discharge for a chief compliance officer who was an at-will employee.

With one exception, New York common law does not recognize a wrongful discharge claim by an at-will employee.[124] The court in *Wieder v. Skala* recognized that exception, holding that a law firm associate could sue an employer for wrongful discharge for terminating the associate in retaliation for internally reporting an ethics breach of a fellow associate.[125] In *Sullivan v. Harnisch*, the

123. *Young*, 135 S. Ct. at 1354–55.

124. *See* Wieder v. Skala, 609 N.E.2d 105, 109–10 (N.Y. 1992); Murphy v. Am. Home Prods. Corp., 448 N.E.2d 86, 89–90 (N.Y. 1983). An employee, however, may show that the employer promised more than at-will employment in a written employment contract or other writing such as an employee handbook. *See* Weiner v. McGraw-Hill, Inc., 443 N.E.2d 441, 445 (N.Y. 1982).

125. *Wieder*, 609 N.E.2d at 109–10.

compliance officer for a hedge fund sought to extend *Wieder* to a claim that he was terminated for reporting wrongdoing discovered as part of his job.[126]

Prior to *Wieder*, the New York Court of Appeals had repeatedly rejected wrongful discharge claims by at-will employees. For example, in *Murphy v. American Home Products Corp.*, the assistant treasurer of a corporation claimed that he was discharged "in retaliation for his revelation to officers and directors of the defendant corporation that he had uncovered at least $50 million in illegal account manipulations of secret pension reserves that improperly inflated the company's growth in income and allowed high-ranking officers to reap unwarranted bonuses from a management incentive plan, as well as in retaliation for his own refusal to engage in the alleged accounting improprieties."[127] The court held that the employee's wrongful discharge claim was properly dismissed because he had no written employment agreement promising anything other than employment at will.[128] Similarly, in *Sabetay v. Sterling Drug, Inc.*,[129] the court upheld dismissal of an employee's claim that he was wrongfully discharged for not participating in illegal financial transactions and later blowing the whistle on the wrongdoing. Again, the court relied on the absence of any contractual promise beyond at-will employment. In both cases, the court left recognition of a wrongful discharge claim to the state legislature.

Like the employees in *Murphy* and *Sabetay*, the law firm associate in *Wieder* did not have an employment agreement or other writing promising more than at-will employment. The court, however, went on to consider whether "an implied-in-law duty" might limit the law firm's otherwise free hand in terminating an associate.[130] The court found such a duty relating to the legal profession's ethics rules:

> [With] any hiring of an attorney as an associate to practice law with a firm there is implied an understanding so fundamental to the relationship and essential to its purpose as to require no expression: that both the associate and the firm in conducting the practice will do so in accordance with the ethical standards of the profession. Erecting or countenancing disincentives to compliance with the applicable rules of professional conduct, plaintiff contends, would subvert the central professional purpose of his relationship with the firm—the lawful and ethical practice of law.[131]

The court rested this conclusion on the single purpose of the associate–law firm employment relationship, namely, the practice of law:

> Defendants, a firm of lawyers, hired plaintiff to practice law and this objective was the only basis for the employment relationship. Intrinsic to this relationship, of course, was the unstated but essential compact that in conducting the firm's legal practice both plaintiff and the firm would do so in compliance with the prevailing

126. 969 N.E.2d 758 (N.Y. 2012).
127. *Murphy*, 448 N.E.2d at 87.
128. *Id.* at 90.
129. 506 N.E.2d 919, 923 (N.Y. 1987).
130. *Wieder*, 609 N.E.2d at 108.
131. *Id.*

> rules of conduct and ethical standards of the profession. Insisting that as an associate in their employ plaintiff must act unethically and in violation of one of the primary professional rules amounted to nothing less than a frustration of the *only legitimate purpose of the employment relationship*.[132]

In addition, the court emphasized that the law firm had terminated the associate for complying with an ethics rule that required attorneys to report ethical misconduct—a rule crucial to preserving the legal profession's right to self-regulate.[133] Combined, the single purpose of the employment relationship and the significance of the ethics rule supported an implied-in-law term of his employment.

In *Sullivan*, the chief compliance officer for a hedge fund sought to fit his claim within *Wieder*'s narrow exception. In addition to serving as the compliance officer, he was a 15 percent partner in the firms constituting the hedge fund and also "Executive Vice President, Treasurer, Secretary, [and] Chief Operating Officer."[134] The plaintiff alleged that he was terminated in retaliation for reporting wrongdoing by the chief executive officer and president, specifically "stock sales amount[ing] to 'front-running'—selling in anticipation of transactions by the firm's clients—and enabled [the CEO and President] to take advantage of an opportunity from which the clients were excluded."[135]

The plaintiff did not have an employment agreement with the hedge fund that promised anything other than at-will employment. The plaintiff, however, relied on three factors to support extension of *Wieder* to his case. First, federal securities laws and the hedge fund's own code of ethics both prohibited the conduct that the plaintiff reported.[136] Second, as the hedge fund's chief compliance officer, the plaintiff was required by federal securities laws and the hedge fund's own policies to monitor and report wrongdoing that the plaintiff had discovered.[137] Third, under the hedge fund's policy, the plaintiff's employment could have been terminated if he did not report the misconduct.[138] To avoid the Catch 22 of being fired for reporting or not reporting, the plaintiff argued for protection under *Wieder* despite his status as an at-will employee.

The court began its analysis by stating that *Wieder*'s exception to at-will employment is to be construed narrowly:

> [W]e intended the exception to the at-will doctrine we recognized in *Wieder* to be a narrow one. The Appellate Division in this case said that *Wieder* is "sui generis," but we do not need to go that far to decide this case. Assuming that there are some

132. *Id.* at 110 (emphasis added).
133. *Id.* at 108–09.
134. *Sullivan*, 969 N.E.2d at 759.
135. *Id*. The complaint alleged a separate claim that termination was in connection with a dispute over the plaintiff's ownership interest in the hedge fund. *Id.* ("[T]he complaint alleges that the dismissal occurred within hours after a lawyer for [the plaintiff] contacted [the hedge fund's] counsel to voice objections to a proposed agreement that would have eliminated [the plaintiff's] ownership interest.").
136. *Id.*
137. *Id.* at 761; *see* 17 C.F.R. § 275.206(4)-7(a), (c) (2015).
138. *Sullivan*, 969 N.E.2d at 759.

> employment relationships, other than those between a lawyer and a law firm[] that might fit within the *Wieder* exception, the relationship in this case is not one of them.[139]

So, while not closing the *Wieder* door to *all* compliance officers, the court did not allow *this* compliance officer to enter. The court specifically rejected the existence of a complex regulatory scheme, such as the federal regulation of hedge funds, as a reason to extend *Wieder*'s protection. While such a scheme surely requires extensive compliance efforts, the court would not modify state common law for that reason alone. This makes much sense in light of the increasingly complex regulatory landscape in which most businesses operate. If the complexity of regulation and corresponding efforts to comply with regulations were sufficient, the at-will employment doctrine would be in danger of extinction.

The court wrote more narrowly when addressing the plaintiff's status as a compliance officer, suggesting how future litigants might come within *Wieder*'s protection:

> Important as regulatory compliance is, it cannot be said of [the plaintiff], as we said of the plaintiff in *Wieder*, that his regulatory and ethical obligations and his duties as an employee "were so closely linked as to be incapable of separation." [The plaintiff] was not associated with other compliance officers in a firm where all were subject to self-regulation as members of a common profession. Indeed, [the plaintiff] was not even a full-time compliance officer. He had four other titles at [the hedge fund], including Executive Vice–President and Chief Operating Officer, and was, according to his claim, a 15% partner in the business. It is simply not true that regulatory compliance, in the words of *Wieder*, "was at the very core and, indeed, the only purpose" of [the plaintiff's] employment.[140]

This crucial passage makes two points that will be key to future litigation. First, and hopefully not dispositive, the court notes that the plaintiff, as chief compliance officer, was not employed in a firm where he was associated with other chief compliance officers for the purpose of practicing compliance. If this factor is enough to negate application of *Wieder*, then compliance officers will never gain common law protection against retaliatory termination. Unlike lawyers, compliance officers do not associate with one another in firms. Indeed, regulations and guidance almost uniformly speak of a business or organization appointing a compliance officer as one of its officers or employees.[141] If this first factor is enough to bar application of *Wieder*, the court would be artificially elevating the form of business association over substance in an effort to cabin artificially a legal doctrine of which it is not particularly fond.

The second factor is more substantive: compliance was not "at the very core and, indeed, the only purpose" of the plaintiff's employment. As noted above,

139. *Id.* at 760–61.

140. *Id.* at 761 (quoting Wieder v. Skala, 609 N.E.2d 105, 108 (N.Y. 1992)).

141. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(C) (U.S. SENTENCING COMM'N 2014), *available at* http://www.ussc.gov/Guidelines/Organizational_Guidelines/guidelines_chapter_8.htm ("Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program.").

the plaintiff not only was the hedge fund's chief compliance officer, but he also wore several other hats, including that of chief operating officer. These various roles may be in conflict or tension at times, making it difficult to know which hat a person is wearing while acting within the organization. This can be seen in the literature discussing whether the chief compliance officer should also either serve as general counsel or report through that position.[142] There, the concern is that delivering legal advice to the corporation may on occasion give rise to conflicts when the same person is also charged with independently evaluating compliance with legal responsibilities. The same could easily be said of serving as both chief operating officer and the chief compliance officer charged with independently overseeing that these same operations comply with the law. When an employee's roles are potentially in conflict, as in these cases, the compliance role is not so central to the employment relationship as to imply a limitation on termination of employment for proper performance of that role. Only when compliance constitutes the employee's sole job responsibility will a court imply such a limitation on termination of employment. This reading of the court's opinion leaves extension of *Wieder* open in future cases.

In light of *Sullivan*'s demanding standard, it is not surprising that the Second Circuit recently refused to extend *Wieder* in *Cruz v. HSBC Bank USA, N.A.*[143] There, the plaintiff "was hired by HSBC as a Vice President and Senior Business Relationships Manager, and his core role at HSBC was to manage accounts and supervise clients."[144] While he "was required to report fraudulent or criminal activity pursuant to the terms of his employment and federal law," the same can be said of many employees in heavily regulated industries. The simple duty to report does not make an employee's "core role" akin to that of a compliance and ethics professional. Thus, not surprisingly, the court decided that the *Wieder* exception did not apply to the plaintiff's employment.[145]

142. *See* Ben W. Heineman, Jr., *Don't Divorce the GC and Compliance Officer: Independence Won't Guarantee Ethical Behavior—Good Culture Will*, CORP. COUNS., Jan. 29, 2010, at 48.

143. 586 F. App'x 723 (2d Cir. 2014).

144. *Id.* at 725.

145. *Id.* ("We conclude that Cruz's employment with HSBC, as alleged in the first amended complaint, does not fall within the Wieder exception.").