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Massive Derivative Suit Settlement for Alleged Management Failure to Prevent Sexual Misconduct

By Kevin LaCroix on November 21, 2017
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The news headlines have been dominated in recent days by appalling revelations that leading politicians, entertainers, political candidates and others have engaged in sexual harassment, assault, and even worse behavior. 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 entered on Monday suggests that this dynamic may not be limited just to attempting to hold individuals to account 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 (to be funded by insurance) of allegations 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 interesting governance and compliance enhancements,

including the creation of a Workplace Professionalism and Inclusion Council. As discussed below, 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.

The company's November 20, 2017 press release describing the settlement can be found [here](#). The parties' November 20, 2017 stipulation of settlement can be found [here](#). A November 20, 2017 Law 360 article about the settlement can be found [here](#).

Background

The lawsuit relates to allegations that numerous women who worked for the company raised 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's 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, against Fox News commentator Bill O'Reilly, and against 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. The same day, counsel for the Retirement System for the first 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 completed and filed with the court.

The Lawsuit

The complaint, which can be found here, 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 company's board, the complaint alleges, “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 overall alleged 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 company's press release confirms that the cash payment is to be made by the company's insurers.)

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 Non-Monetary relief portion of the settlement is detailed in a separate document, here.

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 called to account as well.

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.”

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. There was a time not too long ago when derivative lawsuit settlements rarely involved the payment of substantial amounts of money. As I have noted elsewhere, those days are long gone; in recent years, there has been a series of very substantial settlements. The cash portion of this settlement is among the largest ever.

By my reckoning, this settlement is among the ten largest derivative lawsuit settlements. My best estimate is that this settlement is the eighth largest, although the difficulty of obtaining accurate information about past derivative settlements makes me hesitate from asserting conclusively that this settlement is in fact the eighth largest. (My list of the largest derivative settlements can be found [here](#).)

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 EPL insurance; rather, it alleges management wrongful acts of the kind that would trigger D&O 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.)

Though I think it is clear that this lawsuit is a primarily a D&O lawsuit and not an EPL lawsuit, I can see some D&O insurers having trouble getting their heads around this fact, potentially resulting in coverage issues. Some D&O policies (particularly private company D&O policies) contain exclusions specifying that coverage is precluded for loss “based upon, arising out of, or in consequence of any employment-related Wrongful Act.” The problem with this broad exclusion is that a D&O insurer interpreting this type of exclusion might contend that coverage is precluded by this exclusion for the type of management wrongful act asserted against the 21st Century Fox board — while at the same time the EPL insurer might contend that its policy has no coverage because there is no claim in this lawsuit “for” an employment practices wrongful act. This kind of confusion could result in a claim falling in the cracks between the two coverages. In my view, this would be a mistake as this claim clearly is a management liability claim of the type to which the D&O policy should respond; that in fact appears to be what happened here, as it appears that the company’s D&O insurers did respond to this claim.

In addition to this lawsuit representing a D&O claim, the monetary portion of settlement appears to represent the kind of non-indemnifiable loss to which the Side A coverage portion of a D&O insurance program should respond. The settlement documents do not provide the details about the D&O insurance contribution to the settlement, but to the extent the company’s D&O insurance program includes separate layers of excess Side A insurance, this settlement could (to the extent aggregate loss exhausted underlying layers of insurance) have triggered the company’s Side A insurance.

These details about the insurance may seem technical but these issues potentially could become very significant to the extent there are other claims of this type against companies and boards arising out of the current wave of sexual harassment revelations. If more claims of this type do arise, these kinds of insurance related issues could become critical.

All of that said, the most important significance of this case from my perspective is not just that it settled for a lot of money or that it represents a significant example of remedial measures companies can take to address corporate culture concerns. Rather, the most important significance of this case is that in the current wave of sexual harassment revelations represents more than just a vulnerability of the bad actor individuals to having their misconduct exposed; the ongoing revelations also represents a potential liability exposure for the bad actors' companies and the companies' executives.

In that regard, it is worth noting that two of the lawsuits that women have filed against Harvey Weinstein alleging sexual misconduct have also named as a defendant The Weinstein Company itself; for example one of the lawsuits places blame on the company's "executives, officers, directors, managing agents and employees," alleging they had "actual knowledge of Weinstein's repeated acts of sexual misconduct with women."

The lawsuits against The Weinstein Company are, of course, categorically different than the lawsuit and settlement involving Twenty First Century Fox; the lawsuits against The Weinstein Company were filed by the victims of the alleged misconduct, seeking damages for the harm caused by the alleged misconduct itself. The lawsuit against the senior managers of Twenty First Century Fox was brought by one of the company's shareholders, not by a victim, and the lawsuit seeks damages not for the harm caused to the victims by the misconduct but rather for harm to the company for failing to take steps to prevent the misconduct.

A couple of other notes about this settlement. First, as Jonathan Stemple noted in his November 20, 2017 Reuters article about the 21st Century Fox settlement (here), this is not the first big derivative settlement involving a Murdoch-led company. As discussed here, in April 2013, the parties to the

News Corp. derivative lawsuit entered what was then the largest derivative lawsuit settlement of all time, when they agreed to a \$139 million settlement. The earlier News Corp. settlement was also settled entirely by insurance. According to Wikipedia, 21st Century Fox is one of two companies formed in 2013 when News Corp. spun off its publishing assets.

The other thing about this settlement is its timing. Just in the last few days rumors have been circulating that 21st Century Fox is on the sales blocks. The story that initially circulated in early November was that Disney approached the company about possibly buying some of its assets. Within days, the story changed, with the suggestion that the talks with Disney had been shelved and that Murdock was instead considering a sale of the company (or parts of it) to a range of possible suitors.

If the company is in fact trying to put itself up for sale, taking care of a potentially messy piece of litigation, as well as coming up with a mechanism to try to show that the company had a handle on the simmering sexual misconduct allegations, seem like important measures for the company to take to try to ensure that skittish investors aren't deterred by the companies past problems. To be sure, the mediation to try to resolve this dispute commenced this summer, but it seems to me like more than just coincidence that the settlement (including importantly the measure to try to clean up the companies sexual misconduct problems) was wrapped up just as the company is trying to attract prospective buyers.