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GUEST COMMENTARY

ADDRESSING SEXUAL HARASSMENT CLAIMS AT THE BOARD LEVEL

BY DOREEN LILIENFELD, SHEARMAN & STERLING LLP

In today's environment, no industry is immune from claims of workplace harassment. Allegations can not only tarnish a company's — and a board's — reputation, and impair shareholder value, but imperil the existence of a company.

The Weinstein Company LLC may have been an extreme case, but the events of the last year support the idea that sexual harassment is a reality in all sectors. The biopharmaceutical industry is no exception.

In any company or organization, the problem can stem from just one bad actor, or from a host of them, from individual acts, or from a whole environment. Any of these can have a damaging effect on employee morale, not to mention goodwill of potential investors or partners.

And when allegations do arise, it's essential that boards act quickly. A perception that the company is failing to act, or not responding seriously to harassment claims, will not be viewed favorably by juries or in the court of public opinion.

The responsibility applies to boards of both public and private biopharmas; in both cases the Board has a responsibility to shareholders. While the public disclosure requirements differ between private and public companies, the reputational damage can be lasting.

It's also important that board members understand "allegations" covers all forms of information, not only circumstances where an employee files a case. If a board member gets wind of situations involving sexual harassment over coffee, through the investor community or otherwise, he or she has the same duty to act.

DEALING WITH COMPLAINTS

The importance of dealing speedily and effectively with complaints goes well beyond negative publicity. As with any area of board fiduciary oversight, even the perception of a failure of oversight by the Board can result in shareholder derivative litigation against the Board — that is, an action brought by a shareholder on behalf of the company against a third party, such as an officer or director.

In addition, a failure to show oversight runs the risk of securities class actions in the event of a resulting stock price decline.

Recently, for example, 21st Century Fox settled a shareholder derivative suit alleging that management and the board failed to properly oversee sexual harassment claims, which resulted in a breach of its fiduciary duty, for \$90 million.

In cases where a complaint is lodged against a senior executive who is also a board member, the board should form a special committee to conduct an investigation. This will reduce the potential for conflicts of interest, and help ensure objectivity in the board's assessment of the allegations.

FORMING A SPECIAL COMMITTEE

At the outset, the board needs to determine the scope of the special committee's responsibility: specifically whether the authority to make final determinations rests in the committee, or whether the full board retains that authority. It also needs to decide whether the committee members will receive an additional fee for their activities connected to

the investigation, given the amount of time that could be involved, and in light of market practice and current director fee packages.

Two key questions to consider are how big the committee should be, and who should take part.

While Delaware law permits special committees comprised of as few as one director, it is preferred to have at least three disinterested directors.

In deciding how large to make the committee, the board needs to balance the need for active and robust discussions of the issues and a desire for diversity of viewpoints against the need for a prompt and efficient adjudication of the facts.

Special attention should be paid to the backgrounds of the special committee members — for example, whether they have long board tenure or other close relationships with the party under investigation and whether they have experience dealing with such claims at other companies.

be independent of counsel for the company, and not be a firm commonly involved in defending the company or its executives in day-to-day matters.

The reason for avoiding using the company's regular counsel is that this may weaken an argument about the committee's independence if it comes up in a later review, depending upon the company's relationship with the advisors and the executive under investigation. This should be carefully considered on a case-by-case basis.

DEALING WITH FINDINGS

The key question is what to do if the investigation substantiates the claims. The short answer is that the board needs to act quickly and decisively.

Removing the offending employee swiftly may best protect the company's employees, reputation and future. If a senior executive officer is removed, the board's prior succession planning efforts will come to the fore — and its efficacy will be scrutinized.



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And of course, boards also need to consider the gender composition of the committee, which can be a challenge for less diverse boards.

Finally, the board needs to appoint an independent committee chair to preside over the proceedings. This needs special care as the chair will be the “face” of the investigation and he or she may ultimately be grilled by the press and investors.

SEEKING LEGAL COUNSEL

Special committees now commonly turn to outside advisors for assistance in sexual harassment cases, and that is often a good tactic.

Lawyers add expertise and resources to the investigation, and their work is typically protected by privilege and the attorney work product doctrine. But it's worth noting that in a highly publicized scenario, there will be great pressure on the company by shareholders, the media and potentially regulators to release the results of the investigation.

The committee needs to remain in regular contact with its outside legal team, and should actively oversee the status of the investigation.

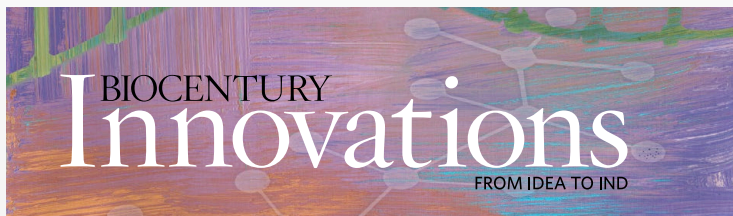
And the board needs to exercise the same wisdom in selecting counsel as in forming the committee: Counsel for the board typically needs to

Terminations have consequences that play into compensation plans and agreements. Often, a material violation of company policy constitutes grounds for termination of employment without payment of severance. Clawback policies should also be reviewed in these circumstances to determine whether any recoupment action need take place.

It's important for boards to review all related disclosures with counsel. If the employee files a lawsuit, disclosure will be required if the proceeding is likely to have a material quantitative or qualitative impact on the company's financial performance. Disclosure can also help the board get ahead of the story to be portrayed in the media.

Although launching an internal investigation doesn't typically necessitate disclosure, a shareholder could argue that failing to disclose an internal investigation — or, more often, its cause — is an omission of material fact if the allegations ultimately lead to a drop in share price or if the subject executive is terminated.

But communications — both internal and external — need delicate handling, in particular in a world of social media. It's often wise to monitor social and traditional media platforms to ensure the investigation has not



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TRANSLATION IN BRIEF

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become public knowledge before its conclusion, and that is often best done by engaging an experienced PR firm.

AN OUNCE OF PREVENTION

The time is ripe for boards to question where their companies stand on compliance, reporting and employee education. Many companies have recently re-evaluated their sexual harassment policies and boards should take an active role in ensuring they represent the values their company embodies, for example by reviewing those policies with the help of advisors.

To be effective, policies must provide clear and effective reporting channels. The board should understand existing reporting protocols, including when reports are to be escalated to the board, and ensure that employees can safely report up. Outside reporting channels like anonymous hotlines and neutral third parties, and mandatory reporting by senior employees, can increase the effectiveness of internal reporting.

Training on proper workplace conduct should be provided on a regular basis at all levels, including to senior executives and board members. Thorough record-keeping of harassment reports, even those that are ultimately deemed unsubstantiated, may help the company detect patterns and better evaluate claims. Finally, boards must bear in mind their role as stewards of corporate culture.

Dealing with sexual misconduct in the workplace is a difficult undertaking for the company and the board. Advance planning on a board's part can alleviate those burdens in the event of such a crisis and avoid potential shareholder claims against the company and the board.

The views expressed here are the author's and do not necessarily represent the partners of Shearman & Sterling LLP or the firm as a whole. bc