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MERGERS & ACQUISITIONS

Sexual Harassment

Sexual harassment risks, whether known or unknown, present real financial risks that must be addressed by buyers and sellers in M&A deals. Akin Gump attorneys look at examples of #MeToo representations and caution that companies ignoring these risks do so at potential peril to their employees, boards of directors, and stockholders.

INSIGHT: #NotMe—Sexual Harassment Risk Assessment in Mergers & Acquisitions



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#MeToo Sexual harassment risks—known, unknown, potential, real or perceived—are economic risks that should be carefully assessed and addressed by both sellers and acquirers in mergers and acquisitions.

In M&A due diligence, parties look beyond financial statements to be able to put a price on intangible risks and assets. Any threatened or pending litigation or insurance claims, including over sexual harassment, should be reviewed and considered during pricing discussions.

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

Sex: Uncomfortable Questions

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

Red flags include:

- documented patterns of misconduct;
- employment agreements providing for severance packages in spite of sexual misconduct;
- separation or settlement agreements that relate to sexual harassment and contain non-disclosure agreements;
- difficulty recruiting or retaining women, particularly at senior levels;
- complaints about work culture or specific individuals;

■ evidence that serious allegations are not made to human resources; and

■ suppressed or unaddressed allegations of sexual harassment.

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

Reps: Ask and Then Tell

In 2018, several acquirers obtained a ''#MeToo rep'': a representation that no credible accusations of sexual harassment had been levied. Variations as to who knew or should have known, to whom the representations apply and for what period of time such representations cover are common, but merger parties across a wide variety of industries, from banking, technology, and private equity to restaurants, healthcare, and photo printing, incorporated a version of a #MeToo rep.

While there is no boilerplate, there is a commonality: parties are making concerted efforts to limit financial exposure to damages relating to past sexual harassment.

Examples include:

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

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

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

Companies with a robust human resources department and whistleblower policies are better positioned to limit the scope of a #MeToo rep than those without. Boards can and should ask for regular management reports on cultural workplace issues and how they are addressed. Potential buyers are likely to request the same. In today's environment, non-money issues are indeed money issues.

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

Remedies: Or Pay the Price

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

However, in high-risk transactions and transactions without a #MeToo rep, acquirers should consider other remedies, such as purchase price clawbacks, escrows, or forfeiture of future executive compensation as insurance against future losses connected to allegations of sexual harassment. Such remedies should be enforceable upon any such allegation that harms the company's reputation, operations, or financial results, even if the allegations do not result in a successful lawsuit or settlement against the company.

Sexual harassment lawsuits and settlements are extraordinarily difficult to win; the lack of a judicially sanctioned remedy does not mean that no harm was done.

In the event that a specific officer or director has been accused of a pattern of sexual harassment or assault such that no representations or certifications could adequately protect a counterparty in an M&A transaction, the counterparty could negotiate for the removal of that person or plan to do so immediately upon taking control. Companies may find it easier to oust such individuals when the tradeoff for shareholders is a lucrative business combination transaction.

Conversely, if there is a person or group of persons that are so intrinsically key to the company's prospects, strategic planning will be required to find a solution that addresses all the issues. Where there is no evidence of harassment but a lack of protections are found, it may be prudent for an acquirer to negotiate a right to termination of certain key persons in the event of a sexual harassment claim and increase the role of human resources, possibly including revising policies and procedures as well, before a change of control.

#NotMe

#MeToo, among other things, has been a catalyst for the creation of tangible financial penalties for failure to prevent sexual harassment in the workplace. Companies that ignore the risk or reality of sexual harassment do so at the potential peril, not only of their employees, but also of their boards of directors and stockholders.

Conversely, companies that actively consider and address sexual harassment will be better positioned to rep #NotMe.

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