

EMPLOYMENT

What Fund Managers Need to Know About the Legislative Response to #MeToo

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As the #MeToo movement presses forward, it has caught the attention of federal and state lawmakers, who have introduced, and in some cases enacted, a range of new legislation to deter and prevent sexual harassment and hold violators accountable. These legislative measures have taken several forms, including legislation (1) prohibiting certain provisions that require the arbitration of sexual harassment claims; (2) prohibiting the use of certain contractual non-disclosure provisions to the extent they cover those claims; (3) requiring firms to adopt sexual harassment prevention policies and training protocols; and (4) expanding coverage of various anti-harassment protections to certain individual contingent workers.

This article explores some of these initiatives, including impactful legislation recently enacted in New York, and discusses the potential consequences for investment managers in the months and years ahead.

See [“How Investment Managers Can Prevent and Manage Claims of Harassment in the Age of #MeToo”](#) (Dec. 14, 2017).

Tax Amendment Eliminates Business Expense Deductions for Sexual Harassment Settlements That Are Subject to Non-Disclosure Agreements

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (TCJA). Flying somewhat under the radar in the law was a provision amending the Internal Revenue Code (Code) to eliminate a tax deduction in connection with the settlement of certain sexual harassment and abuse claims.^[1]

For more on the TCJA, see [“How the Tax Cuts and Jobs Act Will Affect Private Fund Managers and Investors”](#) (Feb. 22, 2018); and [“New Tax Law Carries Implications for Private Funds”](#) (Feb. 1, 2018).

Prior to the TCJA, employment-related settlements were treated as costs of doing business under the Code. Firms were thus able to deduct settlement payments as “ordinary

and necessary” business expenses under Section 162 of the Code. The new law, however, eliminates the tax deduction with respect to “any settlement or payment related to sexual harassment and sexual abuse,” including related attorneys’ fees, where “such settlement or payment is subject to a nondisclosure agreement.”

The scope and reach of this new provision has yet to be determined. The TCJA lacks definitions for many of the key terms (including “sexual harassment,” “sexual abuse” and “nondisclosure agreement”), and regulatory guidance will be needed to clarify open issues, including:

- What payments will be considered “related to” sexual harassment and abuse, and thus non-deductible under the new provision? Is the new provision triggered only when specific harassment claims have been alleged and are subject to a confidential settlement? Or, does the exclusion apply to any general release of claims that contains a non-disclosure provision (since those releases invariably cover causes of action for harassment, among all others)?
- Similarly, what attorneys’ fees will be deemed “related to” a settlement? Does the new law capture only attorney time spent drafting and negotiating the settlement agreement? Conversely, does the exclusion from deductibility also cover time spent defending the underlying claims (such as time spent on legal research; motion practice; advice and counsel; discovery; and trial preparation)?
- If a confidential settlement resolves multiple claims, including sexual harassment claims and other unrelated claims, will the entire settlement be non-deductible? Alternatively, can a firm allocate settlement amounts to the various claims, such that a portion of the settlement remains deductible?
- Is the exclusion from deductibility triggered only when a settlement agreement itself contains a confidentiality provision? Or, will confidentiality obligations imposed by an underlying employment agreement also render a subsequent settlement non-deductible?

- Does the exclusion from deductibility apply to the alleged victim of harassment, as well as to the defendant firm, such that the alleged victim is also prohibited from deducting her attorneys' fees in connection with a covered settlement? This appears to be the case under the plain language of the statute.

Critics have also challenged the wisdom of the new law. In many cases, an alleged victim of harassment has her own interest in a confidential resolution of a dispute, including a desire to maintain her personal privacy or a concern that word of the dispute may impact her future career opportunities. The TCJA does not contain an "opt-out" provision for an alleged victim, thus likely forcing her to choose between maintaining confidentiality of a settlement and maintaining a valuable tax deduction in connection with her attorneys' fees.

The new law may also unwittingly reduce an alleged victim's leverage in settlement negotiations. Firms, like employees, often place considerable value on the confidentiality of a settlement, and the plaintiffs' bar has historically capitalized on that interest by promising confidentiality as part of a negotiated resolution. The TCJA devalues such an overture, in light of the tax consequences of an agreement containing confidentiality protections.

Proposed Bill Would Prohibit Mandatory Arbitration of Sexual Discrimination and Harassment Claims

Weeks prior to the TCJA's passage, another piece of #MeToo-inspired legislation was introduced in both houses of Congress: the Ending Forced Arbitration of Sexual Harassment Act (EFASHA). This bill would amend the Federal Arbitration Act (FAA) to prohibit pre-dispute agreements requiring the arbitration of sexual discrimination or sexual harassment claims.

Specifically, the proposed measure provides that "no predispute arbitration agreement shall be valid or enforceable if it requires arbitration of a sex discrimination dispute." The bill defines "predispute arbitration agreement" to mean "any agreement to arbitrate a dispute that has not yet arisen at the time of the making of the agreement." Accordingly, while a firm and employee could agree to arbitrate a discrimination or harassment claim once the dispute arose, firms could not otherwise require the arbitration of those disputes, including via provisions in their standard employment or confidentiality agreements.

The proposed legislation broadly defines "sex discrimination dispute" to include "dispute[s] between an employer and employee arising out of conduct that would form the basis of a claim based on sex under title VII of the Civil Rights Act of 1964 . . . regardless of whether a violation of such title VII is alleged." The bill thus appears to prohibit pre-dispute arbitration provisions covering state and local discrimination claims, at least to the extent that those claims would be cognizable under Title VII. Like Title VII, EFASHA would cover all firms with 15 or more employees.

On February 12, 2018, the National Association of Attorneys General submitted a letter to Congressional leadership expressing the unanimous support of all 56 U.S. attorneys general for legislation prohibiting the mandatory arbitration of sexual harassment claims.[2] In their letter, the attorneys general argued, among other things, that:

- mandatory arbitration provisions are typically hidden "within the 'fine print' of lengthy employment contracts";
- employees are unlikely to realize that they are subject to such provisions "until they have been sexually harassed and attempt to bring suit";
- arbitrators lack the training of federal judges and "are not positioned to ensure that [harassment] victims are accorded both procedural and substantive due process"; and
- "the secrecy requirements of arbitration clauses" may "prevent other persons similarly situated from learning of the harassment claims" and "pursu[ing] relief."

With Republicans in control of both chambers of Congress and the White House, EFASHA remains unlikely to pass. There have been no hearings scheduled on the bill to date, nor has the bill been scheduled for legislative markup. Nevertheless, with so much national attention focused on the #MeToo movement, EFASHA is a wild card to keep an eye on in the months ahead.

For more on arbitration, see "[How Hedge Fund Managers Can Use Arbitration Provisions to Prevent Investor Class Action Lawsuits](#)" (Jun. 28, 2012).

State Legislative Efforts Regarding Workplace Harassment

In addition to the above federal activity, several state legislatures have trained their focus on sexual harassment in the workplace. The State of New York is at the vanguard of these efforts. Its 2018-2019 state budget, passed into law

on April 12, 2018, (1) prohibits certain contractual clauses requiring the arbitration of sexual harassment claims; (2) prohibits certain confidentiality clauses in agreements resolving sexual harassment claims; (3) requires employers to adopt an anti-harassment policy and training program meeting certain minimum standards; and (4) provides a cause of action to certain non-employee service providers (such as individual independent contractors and consultants) who are victims of sexual harassment in a firm's workplace. Implementing guidance regarding this legislation is expected in the coming months.

Prohibitions on the Mandatory Arbitration of Sexual Harassment Claims

First, the New York law amends Article 75 of the New York Civil Practice Law and Rules (CPLR) to invalidate certain mandatory arbitration provisions to the extent those provisions cover sexual harassment allegations or claims (Arbitration Prohibition).[3] The Arbitration Prohibition is poorly written, however, and faces substantial uncertainty in light of the broad federal preemption of state laws proscribing arbitration. The Arbitration Prohibition covers written contracts that are "entered into on or after the effective date" of the Arbitration Prohibition: i.e., July 11, 2018.

As an initial matter, it is unclear how the Arbitration Prohibition, as written, achieves the statute's apparent objective. The law proscribes pre-dispute mandatory arbitration clauses to the extent such provisions require employees to arbitrate sexual harassment claims as a condition of either (1) "the enforcement of [a] contract"; or (2) "obtaining remedies under the contract." A typical harassment case, however, does not seek to enforce a "contract," and instead seeks to enforce rights under a governing statute. The remedies sought, meanwhile, are not typically contractual in nature, instead deriving from the applicable statute.

Further, the Arbitration Prohibition appears to limit the definition of "mandatory arbitration clause[s]" to clauses "provid[ing] language to the effect that the facts found or determination made by the arbitrator . . . shall be final and not subject to independent court review." Arguably, arbitration clauses that steer clear of this prohibited language will fall outside the statutory definition and thus remain permissible under the new New York law.

Even more fundamentally, the Arbitration Prohibition is likely to ultimately prove toothless in light of contravening federal law. The FAA sets forth a broad "federal policy favoring arbitration"[4] and generally bars state laws that "prohibit[]

outright the arbitration of a particular type of claim." [5] Perhaps because of this authority, the New York legislature included a savings provision in the new law, rendering the Arbitration Prohibition inapplicable where it would be "inconsistent with federal law." Courts are likely to cite this clause in refusing to proscribe mandatory arbitration provisions of the kind typically contained in employment agreements in the investment management space.[6]

Prohibition of Confidentiality Provisions in Sexual Harassment Settlements

The newly enacted New York law also amends the CPLR and the New York General Obligations Law to prohibit confidentiality provisions in certain settlement agreements involving claims of sexual harassment (Confidentiality Prohibition). The Confidentiality Prohibition focuses on non-disclosure provisions covering the "underlying facts and circumstances" of sexual harassment claims; it does not prohibit confidentiality over the amount of any settlement or the other terms or conditions of a settlement agreement.

The Confidentiality Prohibition also contains an exception for matters in which the employee asserting a sexual harassment claim prefers a confidentiality clause.[7] For this exception to apply, the employee at issue must be given 21 days to consider the relevant non-disclosure provision, after which the employee and firm must execute a written agreement stating the employee's preference for confidentiality. (Notably, unlike the 21-day review period for releases under the federal Age Discrimination in Employment Act, the 21-day review period contained in the Confidentiality Prohibition does not appear waivable by the employee). After signing, the employee must be given at least seven days to revoke her signature before the confidentiality provision can take effect. Like the Arbitration Prohibition, the Confidentiality Prohibition takes effect on July 11, 2018 – 90 days after the statute's enactment.

Like New York, the State of Washington recently enacted legislation prohibiting employers from requiring employees to execute confidentiality agreements covering instances of sexual harassment or sexual assault in the workplace. The Washington law contains an exception for non-disclosure provisions contained in settlement agreements signed by the employee.[8] Bills similar to the New York and Washington legislation are currently pending in New Jersey, Pennsylvania, Vermont and California.[9]

Mandatory Sexual Harassment Policies and Training

The recently enacted New York State (NYS) budget also amends the New York Labor Law to require all employers, regardless of size, to implement written sexual harassment policies and annual training programs. The law directs the New York Department of Labor and New York Division of Human Rights to develop both a model harassment policy and model training program, and requires firms to adopt measures that “equal[] or exceed[] the minimum standards provided” by those models.^[10] Certain of these “minimum standards” are set forth in the statutory text.

For example, the model sexual harassment policy must, at a minimum:

1. prohibit sexual harassment and provide examples of prohibited conduct that would constitute unlawful sexual harassment;
2. include, but not be limited to, information concerning the federal and state statutory provisions concerning sexual harassment and remedies available to victims of sexual harassment, along with a statement that there may be applicable local laws;
3. include a standard complaint form;
4. include a procedure for the timely and confidential investigation of complaints that ensures due process for all parties;
5. inform employees of their rights of redress and all available forums for adjudicating sexual harassment complaints administratively and judicially;
6. clearly state that sexual harassment is considered a form of employee misconduct and that sanctions will be enforced against individuals engaging in sexual harassment, as well as against supervisory and managerial personnel who knowingly allow such behavior to continue; and
7. clearly state that retaliation against individuals who complain of sexual harassment or who testify or assist in any proceeding under the law is unlawful.

Meanwhile, the model sexual harassment training program must, at a minimum, include the following:

1. an explanation of sexual harassment, consistent with guidance issued by the NYS Department of Labor in consultation with the Division of Human Rights;
2. examples of conduct that would constitute unlawful sexual harassment;

3. information concerning the federal and state statutory provisions concerning sexual harassment and remedies available to victims of sexual harassment; and
4. information concerning employees’ rights of redress and all available forums for adjudicating complaints.^[11]

Other states are likely to enact legislation regarding employee training as well. For example, Connecticut and California – each of which already mandates harassment training for supervisory employees at firms with 50 or more employees – are currently considering legislation that would, among other things, extend the requirement to smaller employers and require training for non-supervisory employees in addition to supervisors.^[12]

See [“High- and Low-Tech Innovations for Fund Managers to Overcome Compliance Training’s Drawbacks”](#) (Feb. 1, 2018).

Extension of Protections to Certain Contingent Workers

The recently enacted NYS law also expands the NYS Human Rights Law to provide protections to certain non-employees in a firm’s workplace. A firm may be liable to an individual “contractor, subcontractor, vendor, consultant or other person providing services pursuant to a contract” if the firm or its agents or supervisors “knew or should have known that such non-employee was subject to sexual harassment in the employer’s workplace,” and yet “failed to take immediate and appropriate corrective action.”^[13] This section of the statute – which for the first time opens up claims of harassment to individuals who admittedly are not employees – went into effect immediately upon the law’s enactment. Given the large number of consultants and other contingent workers who provide services to investment managers, the new law substantially increases the pool of potential claimants who can assert claims against a firm.

Here as well, other states are likely to follow New York’s lead. Similar bills currently are pending in at least two other states.^[14]

Conclusion: What Now?

The #MeToo movement has ushered in an era of significant change in the laws surrounding sexual harassment in the workplace. The legislative and regulatory landscape is likely to continue evolving at a rapid pace, with bills currently pending on a range of issues in jurisdictions across the nation. At the same time, societal focus on these issues remains intense – a fact that has not been lost on the plaintiffs’ bar. The risk and uncertainty investment managers face with respect to sexual harassment claims thus has never been greater.

The concerns are particularly acute in states like New York, where recent legislation imposes requirements, and creates exposure, beyond that imposed by federal law. Especially in such jurisdictions, firms will need to be proactive in charting their paths forward. For example, while many New York firms already have anti-harassment policies and conduct periodic anti-harassment training, virtually all such modules will need to be overhauled by October 2018, when the new policy and training requirements go into effect. Similarly, New York-based firms that currently maintain – or are considering – arbitration programs should analyze the new law and consider their various options before the Arbitration Prohibition becomes effective. Among the judgment calls firms will need to make are (1) whether they believe the Arbitration Prohibition is enforceable; (2) whether, even if not enforceable, the Arbitration Prohibition may nevertheless have collateral consequences for arbitration provisions; (3) whether they should continue using arbitration clauses going forward; (4) how any such provisions should be drafted; and (5) whether and how they should execute any new arbitration agreements in advance of the new law’s effective date.

Regardless of geography, firms should expect a heightened degree of scrutiny of workplace discrimination and harassment issues for the foreseeable future and should take stock of the steps they are taking to root out behaviors that can lead to such claims. A large part of the legislative focus, both nationally and at the state level, has been to limit firms’ abilities to maintain confidentiality over harassment allegations and – through the TCJA – to financially penalize firms that insist upon confidentiality provisions in connection with their settlements. Particularly in the current environment, the best solution is also the most straightforward: avoiding these claims altogether through a combination of preventative training, state-of-the-art policies and the enforcement of those policies, including by meaningfully disciplining or terminating those employees who violate them.

See [“A Checklist for Evaluating Employee Disciplinary Policies and Procedures of Private Fund Managers”](#) (Mar. 22, 2018). See also our three-part series on best practices for fund managers in developing an employee discipline framework: [“Fostering Predictability in the Face of Inconsistent Laws”](#) (Feb. 8, 2018); [“Investigating and Documenting Employee Discipline”](#) (Feb. 15, 2018); and [“Ensuring a Fair Process When Disciplining Employees”](#) (Feb. 22, 2018).

For firms or associations wishing to become involved in the legislative or rulemaking process itself, there remains an opportunity at both the federal and state levels. The

questions facing lawmakers are multifaceted, with real-world consequences both for firms and alleged victims. As the myriad legislative efforts show, there also are many different ways that potential legislation can be crafted and that the competing interests can be balanced. At a minimum, investment managers should be more attentive than ever to monitoring legislative and regulatory developments in this area and refining their approach accordingly.

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[1] See § 13307 of the TCJA.

[2] See Letter from National Association of Attorneys General re Mandatory Arbitration of Sexual Harassment Disputes, Feb. 12, 2018.

[3] Part KK of S7507-C, Subpart B.

[4] *Volt Info. Sci., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989).

[5] See *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 341, 344, 352 (2011) (quoting *Volt*, 489 U.S. at 478).

[6] New York may not be the only state to pass a law purporting to prohibit the mandatory arbitration of sexual harassment claims. In Maryland, both houses of the legislature recently passed a measure prohibiting any contractual provision that “waives any substantive or procedural right or remedy,” including mandatory arbitration, with respect to a future claim of (1) sexual harassment; or (2) “retaliation for reporting or asserting a right or remedy based on sexual harassment.” See H.B. 1596. Among the other states that have announced or introduced similar legislation are California, South Carolina, New Jersey, Massachusetts and Vermont.

[7] Part KK of S7507-C, Subpart D.

[8] See S.B. 5996.

[9] The California bill would prohibit confidentiality provisions in settlements involving sexual harassment, sexual assault and gender discrimination claims. Settlements of such claims would be void if they purported to prevent the parties from disclosing the underlying facts of the dispute in a subsequent civil action. Similar to the New York provision, the California proposal contains an opt-out provision for confidentiality provisions requested by the employee. See SB-820.

[10] Part KK of S7507-C, Subpart E.

[11] The model training program must also “address[] conduct by supervisors and any additional responsibilities for such supervisors.”

[12] See SB-132 (Connecticut); and SB-1343 (California).

[13] Part KK of S7507-C, Subpart E.

[14] See H.B. 1984 (Tennessee); and H. 707 (Vermont).