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When Your Witness Is a Former Employee

By Linda L. Listrom

It's Monday morning. You are sitting at your desk sipping your third cup of coffee and reading your e-mails when you learn that your company has been sued. Later, as you flip through the pages of the complaint, you discover to your dismay that one of your key witnesses will be a vice president who left the company three years ago. You have not spoken to him since.

In an era when employees change jobs frequently, your most important witness is often a former employee. At best, a former employee may be ambivalent toward your company. At worst, he or she may be downright hostile. Should you contact a former employee? If so, what should you tell him? You may need his cooperation, but the ethics rules limit what you can do to obtain it.

What to Do First

You can and should contact your former employee, and the sooner you do this the better. Undoubtedly, the plaintiff's lawyer will try to contact him. A former employee, particularly one who is disenchanted with his former employer, can be a goldmine for your adversary. The ethics rules do not prohibit your opposing counsel from informally interviewing your former employees. Most jurisdictions have adopted the ABA Model Rules of Professional Conduct, including Model Rule 4.2, which states:

> In representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so.

In 1991 the ABA Committee on Ethics and Professional Responsibility issued a Formal Opinion clarifying that Model Rule 4.2 does not bar ex parte communication with an adversary's former employees. *See* ABA Standing Comm. on Ethics and Professional Responsibility, Formal Op. 91-359 (1991).

In 2002, the ABA issued a revised comment to Model Rule 4.2, again clarifying that the rule is not intended to bar this practice. Today, most courts agree that it is not improper for opposing counsel to contact a former employee of an organizational party, as long as counsel does not ask that person about privileged

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When Delaware Companies Are Required to Advance Fees

A Trio of Delaware Chancery Court Cases

By Kimberly S. Greer

A recent Delaware Chancery Court case may send Delaware companies scrambling to review their bylaws to determine if they are required to advance fees in more instances than first thought. On June 23, 2008, in an instance of first impression, the court held that a company had to advance fees to its prior outside litigation counsel in subsequent litigation by the company against the law firm, under the company bylaws covering advancement of fees for its "agents."

Just four days earlier, the court issued two other opinions in advancement of fees cases which also emphasized that the language of a company's advancement of fees provision is essential to defining when a company has to advance fees. The first case held that a company cannot withhold advancement of fees to its former directors under a broadly worded advancement of fees provision, just because the former directors refused to accept settlement proposals in the underlying securities litigation. The second case held that where the company was only obligated to provide advancement of fees for the defense or

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information. See *Bryant v. Yorktowne Cabinetry, Inc.*, 538 F. Supp. 2d 948 (W.D. Va. 2008).

Step Two

Once you reach your former employee, you should not instruct him to refrain from speaking with opposing counsel. While this is tempting, it is also unethical. Model Rule 3.4(f) provides that a lawyer shall not "request a person other than a client to refrain from voluntarily giving relevant information to another party unless the person is a relative or employee or other agent of the client." You can tell the person that he will probably receive a call from opposing counsel requesting an interview. And you can tell him that he has a choice: He can agree to an interview, or he can refuse. *Fischbach v. Founders Court Inc.*, 1996 U.S. Dist. LEXIS 8256 at *4 (M.D.N.C. May 16, 1996); *North Carolina State Bar v. Graves*, 274 S.E.2d 396, 399 (N.C. Ct. App. 1981).

Can you go further by, for example, asking the former employee to allow you or your outside counsel to be present for any interview by opposing counsel? Generally, the courts frown upon any overt attempt to discourage a witness from speaking with opposing counsel. Several courts have held that it is improper for a lawyer to "instruct" or "advise" a witness not to speak to an adversary unless counsel is present. *See Gregory v. United States*, 369 F.2d 185, 188 (D.C. Cir. 1966); *State v. Mussehl*, 408 N.W.2d 844, 847 (Minn. 1987); *State v. Ben*, 798 P.2d 650, 654 (Ore. 1990); *State v. Hofstetter*, 878 P.2d 474, 480-81 (Wash. Ct. App. 1994). However, a lawyer may "request" to be present for an interview. *See Mussehl* at 408 N.W.2d at 847; *Fischbach*, 1996 U.S. Dist. LEXIS at *5; *State v. Simmons*, 203 N.W.2d 887, 892 (Wis. 1973). There is a fine line separating an instruction from a request. You can stay on the permissible side of this line by explaining to your former employee that he can accept or reject your request. *See Hofstetter*, 878 P.2d at 482.

What to Do About Counsel

Your former employee may ask that the company's outside counsel represent him, particularly if he is likely to be deposed. Should you offer to arrange for your company's outside counsel to represent him? In criminal investigations a former employee invariably must have separate counsel, because there is almost always a conflict between him and the company. The former employee may accuse the company of wrongdoing, or may become a target of the investigation. By contrast, in civil cases there is usually no such conflict. In most cases your counsel can simultaneously represent both the company and the witness. *See Guillen v. City of Chicago*, 956 F. Supp. 1416, 1422-27 (N.D. Ill. 1997); *Bonner v. Guccione*, 1997 WL 91070 at *2 (S.D.N.Y. March 3, 1997); *D.S. Magazines, Inc. v. Warner*

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The Supreme Court And Business

A Year of Stare Decisis *And Punitive Damages*

By Anthony Michael Sabino

Recently, we witnessed the annual ritual of the United States Supreme Court releasing its most monumental decisions in the waning days of its term. The front pages were consumed with new landmarks on, among others, the Second Amendment and the death penalty. The general public and the media rightly gave greater import to these constitutional decisions, but does that mean that American business was ignored by the Justices this year?

Certainly not. The High Court gave business its due, and propounded at least two opinions of significance to the corporate community. While resolving matters important to the conduct of American business, their greater significance lies in what lessons we can draw from them for future business planning.

CBOCS West, Inc. v. Humphries

The first of these two noteworthy Supreme Court decisions is *CBOCS West, Inc. v. Humphries*, ___ U.S. ___ (May 27, 2008). "CBOCS" is an acronym for the owner of the Cracker Barrel restaurant chain, which had been sued by Mr. Humphries, a former assistant manager at one of the former's locations. Humphries, an African-American, claimed his employer dismissed him in retaliation for complaining about racial discrimination against another African-American employee. Humphries' action was based on 42 U.S.C. § 1981, a post-Civil War statute that guarantees equal rights to contract for all citizens regardless of race. The gist of CBOCS' defense was that the proviso did not encompass claims for retaliation. The Seventh Circuit Court of Appeals agreed with Humphries, and the employer appealed to the nation's highest court.

From the outset, the Justices emphasized that the doctrine of *stare decisis* would play a key role here. In 1969, the Court heard a similar question on a sister statute, Section 1982, which focused upon the rights of black citizens to own property. Significantly, both sections were part of the 1866 Civil Rights Act.

The parallel statute had been ruled upon nearly 40 years before in *Sullivan v. Little Hunting Park, Inc.*, 396 U.S. 229 (1969), where a white landowner had rented property to a black tenant, including the right to use a certain public park the corporate defendant owned. The corporation refused to recognize the tenancy, and when Sullivan protested, the corporation expelled him. Although Sullivan was white, the Supreme Court found that foreclosing a remedy to him for this retaliation would only perpetuate racial restrictions on property. *Sullivan*, 396 U.S. at 237.

The *CBOCS* Court noted that beginning with *Sullivan,* it has decided Sections 1981 and 1982 similarly, given their "common language, origin, and purposes." This remained unchanged, even when an intervening decision by the High Court for a brief time narrowed the availability of Section 1981 relief. And brief that interval was, for when Congress passed the 1991 Civil Rights Act, it reinforced the notion that the statute does indeed provide a remedy for retaliation committed as an extension of a racially discriminatory act.

Writing for the Court, Justice Stephen Breyer stated the "upshot" of all this was as follows: In 1969, *Sullivan* recognized a retaliation claim in Section 1982; Sections 1982 and 1981 have long been interpreted in like fashion by the high Court; the 1991 Civil Rights Act confirmed retaliation claims are a component of Section 1981; and lower courts have uniformly interpreted it as such to the present day.

All this led the Supreme Court to conclude that retaliation claims pursuant to Section 1981 are now "well embedded" in the law. That being so, the doctrine of *stare decisis* comes into play, according to Justice Breyer, making it difficult for the proponent of an opposing view to prevail. In this case, the high Court found that CBOCS' arguments did not justify a departure from what was the existing law.

For instance, CBOCS was correct in noting that Section 1981's language does not expressly encompass retaliation. Yet the Court has long held that its sister provision, Section 1982, was broadly worded enough to permit retaliation claims related to racially discriminatory acts. Given that the Justices have interpreted both provisos in tandem, Section 1981 shared the same attributes of its kin. Next, the 1991 Civil Rights Act was clearly intended by Congress to maximize, not proscribe, the penalties for race-based discrimination, and a cause of action for retaliation connected to such wrongs fell within its ambit. Third, a retaliation remedy derived from this Reconstruction era law would not overlap other, more recent federal civil rights laws. Each supplements the others, in order to provide the most comprehensive relief, opined Justice Breyer. In closing, the Supreme Court was compelled by consideration of principles of stare decisis to interpret Section 1981 and its brethren as providing rights of action for retaliation in race discrimination cases.

Exxon Shipping Co. v. Baker

Our second landmark is *Exxon Shipping Co. v. Baker*, ____ U.S. _____, better known as the "Exxon Valdez" case. As has been extensively documented, Exxon's ill-fated tanker ran aground off Prince William Sound, AK, in March, 1989, and the resultant oil spill caused devastation to the surrounding environment, marine life, and economic activity of the resident community. Years of trials and appeals followed, and in that course of time Exxon spent around $ 2.1 billion in cleanup efforts, paid fines and restitution of over $100 million, consented to pay at least $900 million toward

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Supreme Court

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restoring natural resources to the affected area, and paid another $303 million in voluntary settlements with fisherman, property owners, and other private parties.

The paramount issue before the Supreme Court was the constitutionality of the $2.5 billion punitive damages award resulting from the remaining consolidated civil cases. To be sure, there was a neat question as to the availability of punitive damages pursuant to federal maritime law, but since that matter is not of such great import to those outside the admiralty bar, we will bypass it here (although we commend it for further reading for anyone involved in the maritime industry).

Punitive Damages

But before we go further, it must be noted that *Exxon* cannot be read in isolation; therefore, we need to delve into the present state of punitive damages in American law. In recent times, punitive damages have been challenged as violating the Eighth Amendment prohibition against "cruel and unusual punishment." U.S. Const., Amend. VIII. In addition, constitutional challenges have been based upon the Fifth Amendment guarantee of due process, with the assertion that excessive punitive damages awards violate the due process rights of the defendant. *See* U.S. Const., Amend. V. Certainly, punitive damages have long been recognized as fulfilling the twin aims of punishing malefactors and deterring them and others from repeating such egregious behaviors. Yet the Supreme Court has long wrestled with balancing the laudable goals of punishment and deterrence against ensuring that constitutional protections against abusive punishments are honored.

Among the many cases on point, two critical touchstones are *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), and *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003). *BMW* disallowed a colossal sum of punitive damages when compared with the relatively small amount of compensatory damages awarded (the ratio was 500:1); notably, however, the Justices adamantly refused to announce a bright-line test for measuring the constitutional validity of such judgments. Most recently, *State Farm* addressed a situation where the dollar amount of the punitive damages awarded in an insurance coverage dispute exceeded the compensatory damages by a ratio of 145:1. The Supreme Court could not countenance such a disparity, recognizing that such an outsized judgment was constitutionally defective.

In reasoning still much debated to date, *State Farm* indicated that a double-digit ratio of punitives to compensatory damages would almost always fail as a constitutional matter, while a single-digit ratio, *i.e.*, anywhere from 1:1 to 9:1, would, more likely than not, pass constitutional muster. And while again not providing a bright-line rule, any sensible reading of *State Farm* reveals that a ratio of up to 3:1 for punitive to compensatory damages is the safest from the risk of reversal on appeal.

The Ruling in Exxon

With all that as vital prologue, we can turn back to *Exxon*. Writing for the Court, Justice David Souter gave a full and fair exposition of the historical development of punitive damages and the safeguards against abusing same. Indeed, Justice Souter emphasized that driving the Court's analysis today was the desire to regulate them as a common law remedy, responsibility for which lies with the judges who created it.

After an extensive study of the checks and balances imposed upon factfinders in order to prevent abuse, the High Court remarked that in a "well-functioning system" a ratio of punitive damages to compensatory damages in the lower range of possible outcomes better reflected a jury's sense of reasonable punishment, absent earmarks of exceptionally offensive wrongdoing or an exceptionally low amount of actual damages that would render a smaller ratio ineffective. Thus, in a case such as the one before it, the adoption of a 1:1 ratio was a "fair upper limit" of punitives to compensatory damages. Indeed, the Court made very clear that this finding was very consistent with its prior ruling in *State Farm*, and thereby reaffirmed that the single digit maximum "is appropriate in all but the most exceptional of cases."

At the heart of the Supreme Court's conclusion was its great emphasis on the fact that the trial court had awarded the injured parties over $500 million in actual damages. Applying the now-approved 1:1 ratio, the Justices declared an award of punitive damages in like amount "yields the maximum punitive damages." In so doing, the High Court approved a punitive damage award matching dollar for dollar the compensatory damages already decided upon. And so, the final chapter of the tragedy of the Exxon Valdez was written.

At first blush, businesses and their counselors might cheer the *Exxon* decision as a great victory, insofar that it mightily reduced the punitive damages award, and appears to put another precedent on the books towards rationalizing such awards. But not so fast.

There is a great deal more to *Exxon* than meets the eye here. Again, while not visiting the admiralty issues, the point is inescapable that this is at bottom a maritime case. For that reason alone, the courts may be strongly disinclined to rely upon it outside that domain. This of course leaves us with the body of punitive damage landmarks, some of which we highlighted above. We can expect those more general precedents to carry greater weight going forward that the circumscribed reach of *Exxon*.

Likewise, don't be fooled by the approval of the 1:1 ratio in *Exxon*. In no way, shape or form did the Court back away from its *State Farm* ratification of any single-digit ratio, albeit while reserving double-digit ratios for exceptional cases. The smart move is to view as quite deliberate the Court's mention of *State Farm* and its acceptable range of single-digit ratios. That leaves a great deal of room open, in the right circumstances, for a higher court to rebuff any constitutional challenge to a punitive damage award, even if that award is at a ratio of 8 or 9 to 1.

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Delaware Chancery Court Allows Board To Abandon Sales Process

Board's Conduct Receives The Protection of the Business Judgment Rule

By Robert S. Reder and Alison Fraser

Earlier this year, the Delaware Chancery Court dismissed a claim by shareholders of First Niles Financial, Inc., alleging that the directors breached their fiduciary duty by abandoning a sales process, despite receiving offers that its financial adviser found to be "within a range supported by its financial models." The court's decision in *Gantler v. Stephens*, 2008 WL 401124 (Dec. Ch. Feb. 14, 2008), is important in two respects. First, the court affirmed a Delaware board's right to abandon a sales process and, in effect, "just say no" to a merger proposal. Second, the court applied the deferential business judgment rule, rather than a more intrusive standard, in reviewing the Board's actions.

First Niles Sales Process

In August 2004, the Board of Directors of First Niles authorized a process to sell the company, and retained financial and legal advisers to assist with this process. The Board's financial adviser, Keefe, Bruyette & Woods, a well-known financial services sector investment banking firm, contacted six prospective bidders, three of whom submitted bids. One bidder, Farmers National Banc Corp., stated it had "no plans to retain the current First Niles board." A second bidder, Cortland Bancorp, offered a mix of cash and stock representing a 3.4% premium over First Niles' share price. A third bidder, First Place Financial Corp., offered a stock-for-stock transaction with an exchange ratio representing a 3.4% to 6.3% premium. At the next regularly scheduled Board meeting, Keefe, Bruyette & Woods reported that "all three bids were within a range supported by its financial models, and the stock-based offers would be better than retaining First Niles shares." The Board directed management and its financial adviser to continue the process with Cortland and First Place (but not with Farmers).

Management apparently dragged its feet in permitting the two bidders to conduct due diligence, stating that "there was other more pressing business at the Bank." Frustrated, Cortland withdrew its bid. First Place eventually was allowed to conduct due diligence and revised its proposed exchange ratio to an amount representing an 11% premium. Keefe, Bruyette & Woods again found this bid to be "within an acceptable range and to exceed the mean and median comparable multiples" for comparable transactions. Subsequently, and before the First Niles Board met to consider its offer, First Place again revised its bid to increase the exchange ratio. A special meeting of the First Niles Board was called to consider the First Place proposal and a memorandum from Keefe, Bruyette & Woods "positively describing First Place's revised offer" was circulated to the directors. When the Board met, but without any discussion, the directors rejected First Place's offer by a 4-to-1 vote and abandoned the sales process. Instead, the Board decided to pursue, and ultimately completed, a reclassification transaction to privatize the company which left the Board and management in place.

Fiduciary Duty Claims Brought By Shareholders

In November 2006, the plaintiffs (who included the former director who cast the sole vote in favor of proceeding with the First Place bid) filed suit against First Niles and several of its directors and officers claiming, among other things, that the directors had breached their duties of loyalty and care by rejecting First Place's offer and abandoning the sales process. The plaintiffs sought both equitable relief in the form of rescission of the reclassification transaction and compensatory damages.

The directors attempted to argue that their decision to reject First Place's offer and terminate the sales process "cannot form the basis of a breach of fiduciary duty, because the directors owed no duty to the shareholders to sell the company." Rejecting this argument, the court found that "while the Directors may not have had any duty to sell the Company, they still had to satisfy their traditional fiduciary duties." Accordingly, the court proceeded with an examination of the directors' conduct in connection with the sales process and the reclassification transaction. Following a detailed analysis of the relevant facts and judicial precedent, the court concluded that the directors' actions were "entitled to the business judgment presumption" and granted their motion to dismiss the fiduciary duty claims relating to the sales process.

Unocal 'Enhanced Scrutiny' Standard Not Applicable

The first issue the *Gantler* court confronted was the standard of review to apply in scrutinizing the Board's actions. Plaintiffs argued that enhanced scrutiny under the doctrine developed in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 949 (Del. 1985), was appropriate because, in their view, the directors had abandoned the sales process in order to entrench their positions with the company. The *Unocal* doctrine was developed by the Delaware courts as the standard of review when "directors took defensive measures in response to a perceived threat to corporate policy and effectiveness which touches upon issues of control." Generally, the *Unocal* standard is applied to analyze defensive measures adopted by a board in response to a hostile takeover attempt or deal-protection measures included in a negotiated merger agreement. The *Gantler* court, recognizing that the sales process was undertaken at

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Business Judgment

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the behest of the Board, rejected plaintiffs' argument, largely due to the absence of a hostile takeover attempt or any threatening action to indicate that the directors' actions were "defensive" in nature. According to the court, "in the context of a board's rejection of a merger offer, as opposed to taking a defensive measure against a tender offer, unexceptional entrenchment allegations of the kind made here are insufficient to take the challenged decision out of deferential business judgment review."

Business Judgment Rule v. Entire Fairness

Having failed in their attempt to convince the court to apply the *Unocal* standard to the Board's actions, the plaintiffs next sought a determination that the exacting entire fairness standard, rather than the deferential business judgment rule, was applicable. Traditionally, the business judgment rule "applies when a decision of the directors is questioned, and the analysis is primarily a process inquiry." In *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985), the Delaware Supreme Court described the business judgment rule as "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." If the business judgment rule applies, "[c]ourts give deference to directors' decisions reached by a proper process, and do not apply an objective reasonableness test in such a case to examine the wisdom of the decision itself."

In order to rebut the business judgment presumption, plaintiffs "must allege sufficient facts from which the court could reasonably infer (1) a majority of the individual directors were interested or beholden or (2) the challenged transaction was not otherwise the product of a valid exercise of business judgment." If the plaintiffs are successful in this regard, the business judgment presumption is inapplicable and, the burden is shifted to the defendant directors to prove the entire fairness of the transaction, both in terms of the price paid and the process followed. It is generally very difficult for directors to carry this burden, which often makes the court's selection of the applicable standard of review outcome determinative.

The *Gantler* court, citing three reasons, determined that it was not appropriate to shift the standard of review from the business judgment rule to the entire fairness standard. First, since the challenged action was the Board's decision *not* to accept a merger proposal, there was no transaction to subject to an entire fairness analysis. In other words, how could the court examine the fairness of a price when no price was actually paid? Second, alluding to its earlier determination not to apply the *Unocal* standard, the court reasoned that application of the entire fairness standard would be "anomalous in that it would subject the Board's action not to do a merger to more demanding review than a defensive measure adopted for the express purpose of thwarting a hostile tender offer."

Third, and probably most important, the court answered affirmatively the two key questions for determining whether to apply the presumption of the business judgment rule: "(1) did the Board reach their decision in good faith pursuit of legitimate corporate interests, and (2) did it do so advisedly?" The first question bears on a board of directors' duty of loyalty, while the second addresses the board's duty of care.

Analysis of the Board's Conduct

Duty of Loyalty

With respect to the first question, the court did not find sufficient evidence to infer that the directors were acting for the primary purpose of entrenching themselves in office or otherwise acting disloyally. "[I]n most instances … a decision to decline merger discussions will be part of a decision to continue to manage the corporation to enhance long term share value." The court distinguished its decision from the decision in *Chrysogelos v. London*, 1992 Del. Ch. LEXIS 61 (March 25, 1992), where the directors' actions beyond "just saying no" to an unsolicited merger proposal "provided much greater cause for suspicion than the facts alleged in this case." In *Chrysogelos*, the directors also adopted a shareholders rights plan and then reduced the triggering ownership threshold of that plan, purchased a sizeable block of stock on the market at a "substantial premium" and approved "golden parachutes" for management in the event of a change in corporate control.

Duty of Care

With respect to the second question, the court found that the Board's "extensive discussions with, and the receipt of reports from, its Financial Advissr and the involvement of specially retained outside counsel as part of the Sales Process" rendered the facts alleged insufficient to infer that the Board did not act with due care. It is worth noting that the court reached this conclusion despite the facts that: 1) the Board failed to consider the Farmers bid; 2) Cortland withdrew from the process due to its frustration with its inability to conduct due diligence; 3) Keefe, Bruyette & Woods provided a favorable report to the Board as to the adequacy of the bids; 4) the Board rejected the First Place bid and abandoned the sales process without any deliberations among the directors at the special meeting; and 5) the alternative course pursued, a reclassification resulting in the privatization of First Niles, was orchestrated, and decidedly favored, by management and left the Board of Directors intact. While this was perhaps not the best record from which to argue for the exercise of due care, and the Board certainly could have been more proactive in its oversight of the sales process, it was obviously sufficient for the court's purposes.

Conclusion

Even though the First Niles Board began a sales process and received seemingly attractive offers, but then abandoned the process in favor of a reclassification plan favored by management that kept the directors in office, the *Gantler* court was not prepared to overturn the Board's

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Mandatory Wellness Programs

Considerations for Avoiding Legal Pitfalls While Ensuring Organizational Health

By Tiffani L. McDonough

Most employees typically spend more than half of their waking hours at work. Unsurprisingly, work culture can have a serious impact on their health. As a result, many companies have designed wellness programs to promote a healthier work environment and prevent and manage diseases in an effort to maintain employee health and productivity. Another significant consideration for implementing a wellness program is combating the rising costs of health care coverage. Specifically, these programs are created to encourage a healthier lifestyle, with the expectation that such behavioral changes will, in turn, create a healthier work force resulting in lower employer insurance premiums. Because certain preventable health conditions, such as obesity and tobacco-related illnesses, are significantly contributing to the overall decline in employee health and rising expense of health care coverage, employers are responding by providing services such as discounted gym memberships and employee assistance programs including nutritional counseling and/or health coach services.

Voluntary vs. Mandatory

Although voluntary wellness programs are quite common, employers are increasingly implementing mandatory wellness programs, which require an employee to participate in the program or otherwise suffer a penalty. These programs may require, for example, that employees take a health risk assessment as a requirement of eligibility for health insurance coverage or participate in weekly stress management classes. Some more stringent programs require employees to refrain from unhealthy lifestyle choices, such as tobacco use or poor dietary choices. In some cases, companies monitor workers' lifestyle choices by mandating testing. For instance, if the mandatory wellness program requires employees to refrain from tobacco use, the employer may require them to undergo periodic nicotine testing.

While often a healthy asset for organizations, the increasing use of mandatory wellness programs can also present liability risks for companies, including potential violations of employee privacy rights, the federal anti-discrimination laws, such as the Americans With Disabilities Act (ADA), the Health Insurance Portability and Accountability Act, and state legislation regarding the regulation of an employee's lawful off-duty conduct. In addition to the interplay of these programs with both existing federal and state law, the recently passed Genetic Information Nondiscrimination Act (GINA) of 2008, effective Nov. 21, 2009, must be factored into the administration of such plans. Although the Act provides that the EEOC will issue final regulations under GINA within the next year, it is imperative that employers act now to avoid liability. Employers should review current wellness plans to ensure compliance, especially with the Act's confidentiality provisions. Companies who violate the Act face severe penalties — as much as $300,000 for each violation. The broad definition of "genetic information" under the Act puts even the best-intentioned employers at risk of a violation.

Avoiding the Legal Pitfalls

To avoid litigation, the proper balance must be struck between mandatory wellness programs and employee rights. As an initial matter, employers should have a business objective when implementing a mandatory wellness program. This may be as simple as stress reduction at work. Nonetheless, employers should be able to link the goals of the wellness program to employee job performance.

Compliance with the Americans With Disabilities Act (ADA)

Employers must be careful in designing mandatory wellness programs to ensure compliance with the law. Such programs, if not properly administered, may face myriad legal challenges under federal anti-discrimination statutes and privacy laws. One of the biggest challenges is reconciling mandatory wellness programs with the requirements of the ADA, which prohibits employers from discriminating against a qualified individual with a disability in any aspect of employment, including employee compensation and benefits. Specifically, employers must be mindful of the ADA's confidentiality requirements. For example, the ADA limits the disclosure of employee medical information. Therefore, an employer should retain an independent third party administrator to collect and analyze medical information obtained in connection with a mandatory wellness program to ensure that individual health data is not disclosed to the employer. Additionally, employers must be cognizant that although a disabled individual can perform the essential functions of his/her position, he/she may not be able to maintain certain health criteria required by the wellness program because of his/her disability. For example, a disabled employee may not be able to maintain a set body mass index because of certain health conditions.

Title VII of the Civil Rights Act

Another factor to be considered in implementing a mandatory wellness program is the implications of Title VII. As a practical matter, gender differences should be factored into the goals of the program. For example, a healthy body mass index for women is higher than it is for

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men. As such, both male and female employees should be held to the medically accepted standards of their respective genders.

State Law Protections Afforded to Lawful Off-Duty Conduct

Likewise, because many states have statutes that protect employees from adverse employment actions for lawful off-duty conduct, employers need to take caution when regulating employees outside of the workplace. Notably, under New York law, employers may not take adverse action against employees for any otherwise lawful off-duty conduct. Some states limit the scope of protection to specific off-duty conduct. In New Jersey, for example, an employer may not take adverse action against employees for the use of tobacco products. Consequently, mandatory wellness programs applicable to employees in states with such statutory protections may not penalize employees for their lawful off-duty conduct. As such, employers must consult relevant state legislation when implementing these programs.

Compliance with the Genetic Information Nondiscrimination Act Of 2008

On May 21, 2008, President Bush signed GINA, which prohibits employers and group health plans from discriminating on the basis of "genetic information" and places strict limitations on the collection of such information. GINA imposes three main restrictions on employers: 1) employers cannot discriminate in the terms or conditions of employment based upon genetic information; 2) employers are prohibited from retaliating against an employee who opposes genetic discrimination; and 3) employers are barred from collecting genetic information about an employee or an employee's family member whether by request, mandatory disclosures, or purchase from a third party.

Although approximately 34 states have already passed laws prohibiting genetic discrimination in employment, GINA is notably broader than many of the existing state laws. Specifically, the Act's definition of "genetic information" is extremely broad. GINA does not preempt more restrictive state laws, however, its broad provisions place even the best-intentioned employers at greater risk of violation.

According to GINA, "genetic information" includes the results of genetic tests as well as an individual's family medical history. Specifically, "genetic information" is defined as information about: 1) an individual's genetic tests; 2) genetic tests of the individual's family members; and 3) and the manifestation of a disease or disorder in the individual's family members. Consequently, although an employer may not necessarily be obtaining information through traditional genetic counseling, information related to an employee's family medical history would nonetheless fall under the purview of the Act and should be treated accordingly. Moreover, GINA does not limit the information about medical conditions to biological relatives or hereditary disorders. Thus, it applies to spouses and adopted children of an individual, even though the employee does not share the same family medical history.

GINA carves out an exception, however, for requests for genetic information in connection with employer wellness programs. To qualify, four conditions must be met: 1) the employer offers health or genetic services (*i.e.*, as part of a wellness program); 2) the employee provides prior, knowing, voluntary and written authorization; 3) only the employee and the licensed health care professional or board certified genetic counselor involved in providing the services may receive individually identifiable information related to the service; and 4) the employer receives information about such services only in aggregate terms that do not disclose the identity of the employee. Furthermore, companies are required to maintain genetic information as a confidential medical record under the ADA. As such, genetic information must be treated as confidential, maintained on separate forms and in separate files, and protected from unauthorized access.

What to Do Now to Avoid Future Liability Under GINA

Prior to GINA's effective date, employers should take proactive measures to ensure that wellness programs are compliant with the Act's requirements. Employers should update their policies addressing the confidentiality of employee information. For example, an employer should examine how it collects and maintains genetic information, such as information about an employee's family medical history.

Employers must be careful before implementing an employee medical screening initiative that evaluates an employee's propensity for genetically linked medical conditions. If an employer uses health risk assessments to collect information as part of its wellness program, it should tailor the questions to avoid disclosure of genetically-linked medical conditions. If an employer chooses to obtain this information, however, it must ensure voluntary employee participation and obtain written consent before collecting the information. Additionally, third party administrators should collect such information as to keep specific employees' identities from being disclosed. Finally, all information obtained through genetic counseling must be maintained in separate files and internal access should be strictly limited to those with a need to know.

Conclusion

It is axiomatic that a healthier workforce will increase overall employee productivity and result in a reduction in health care costs. Although many employees appreciate the availability and benefits of an employer sponsored wellness program, employers must be mindful of the limitations inherent in these programs and ensure that they are compliant with both state and federal law. By updating practices on the collection of genetic information to ensure compliance with the requirements of GINA, employers will decrease their potential risk of liability under the Act.

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Former Employee

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Publisher Services, Inc., 623 F. Supp. 624, 625 (S.D.N.Y. 1985); *United States v. Occidental Chemical Corp.*, 606 F. Supp. 1470, 1474 (W.D.N.Y. 1985); *Aspgren v. Montgomery Ward & Co.*, 1984 U.S. Dist. LEXIS 21892 at *4-6 (N.D. Ill. Nov. 19, 1984), clarified, 1984 U.S. Dist. Lexis 20927 (Dec. 27, 1984).

By retaining counsel for your former employee, you can prevent opposing counsel from conducting an informal interview. Model Rule 4.2 prohibits a lawyer from communicating with a person who is represented by counsel without his lawyer's consent. Although lawyers sometimes complain when an adversary shields a former employee from internal interviews by retaining counsel, most courts have been unsympathetic to this argument. *See In re Coordinated Pretrial Proceedings in Petroleum Products Antitrust Litigation*, 658 F.2d 1355, 1361 (9th Cir. 1981); *Guillen*, 956 F. Supp. at 1424 n.8; *Occidental Chemical*, 606 F. Supp. at 1476; *Aspgren*, 1984 U.S. Dist. Lexis at *4.

If you plan to provide legal representation to your former employee, it is important that you obtain his consent to the representation. Your outside counsel represents the company. He or she does not represent a former employee unless and until the former employee has consented to this arrangement. *See Brown v. St. Joseph County*, 148 F.R.D. 246, 250-51 (N.D. Ind. 1993). Your former employee and outside counsel should document their agreement by signing a formal retention letter. Even if there are no actual conflicts, your counsel should explain the potential hazards of joint representation to both the company and the former employee, and obtain their consent to joint representation. *See Guillen*, 956 F. Supp. at 1426-27.

If the former employee does not ask for legal representation, you probably should not offer it. The anti-solicitation rules prohibit a lawyer from offering to provide legal representation, at least in some circumstances. *See* Model Rule 7.3. At least two courts have held that a company's outside counsel created an appearance of impropriety by offering to represent a company's former employees free of charge. *See Occidental Chemical*, 606 F. Supp. at 1477; *Aspgren*, 1984 U.S. Dist. LEXIS 21892 at *6-15. As the court reasoned in *Aspgren*, such an offer encourages former employees "to seize on the opportunity of free representation without evaluating the advantages of independent counsel. Because the deponent might feel pressure to get representation for the deposition, the offer can become coercive." *Id.* at *11.

Compensation

Unfortunately, most former employees, especially those who are now working for someone else, expect to be compensated for their time. Model Rule 3.4 states that a lawyer shall not "falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is prohibited by law." However, in a 1996 informal opinion, the ABA concluded that this rule permits a party to compensate a witness for time spent preparing to testify, "as long as it is made clear to the witness that the payment is not being made for the substance or efficacy of the witness's testimony, and is being made solely for the purpose of compensating the witness for the time the witness has lost … " ABA Standing Comm. on Ethics and Professional Responsibility, Formal Op. 96-402 (1996). Since then, many state ethics committees have adopted a similar rule. *See* Compensating Fact Witnesses, 184 F.R.D. 425, 426 n. 4 (1999) (listing states). However, at least two states — Pennsylvania and New Jersey — do not permit a lawyer to compensate a fact witness for time spent testifying or preparing to testify. *See* Pennsylvania Bar Association Comm. on Legal Ethics and Prof'l. Responsibility, Informal Op. 95-126A (1995); *In re PMD Enterprises, Inc.* 215 F. Supp. 2d 519, 529 (D.N.J. 2002). Therefore, before agreeing to such an arrangement, be sure to consult the local ethics rules and related case law.

Of course, the fact that you can compensate a former employee does not mean that you should. One of the disadvantages of doing so is that your opposing counsel will cross-examine the person about this financial arrangement. But, there are some former employees who stubbornly refuse to spend time with you or your outside counsel unless they are paid. If you are forced to choose between paying a witness to prepare for this deposition and allowing him to testify without preparation, the former is usually preferable to the later. Nevertheless, unless your former employee demands compensation, you should not offer it.

Financial Inducements

While most states permit you to pay a witness an hourly fee for his or her time, you cannot offer him any other financial inducements to testify. *See State v. Solvent Chemical Co.*, 166 F.R.D. 284, 289 (W.D.N.Y. 1996). You also must not create even the appearance that you are paying the witness for his testimony. For example, you should not offer to pay a fee on the eve of a former employee's deposition. *See Solvent*, 166 F.R.D. at 290. Both the hourly rate and the total amount of the fee must be reasonable. *See* ABA Formal Op. 96-402. If the former employee now runs his own consulting business, he should be paid his regular hourly rate. *See Prasad v. MML Investor Services, Inc.*, 2004 WL 1151735 at *7 (S.D.N.Y. May 24, 2004). Otherwise, he should be paid a fee that is reasonable based on all of the relevant circumstances, such as his relevant experience and the complexity of the assignment. *See* ABA Formal Op. 96-402; *Centennial Management Services, Inc. v. AXA Re Vie*, 193 F.R.D. 671, 680 (D. Kan. 2000). Once you agree on the hourly rate, you or your outside counsel should supervise the former employee to ensure that the total amount of time he expends preparing to testify is reasonable. *See Centennial Management*, 193 F.R.D. at 680.

If you must pay a fee to your former employee, he and your company should sign a written consulting agreement. The agreement should reiterate that your company is paying

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Advance Fees

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other defensive disposition of actual or threatened proceedings, the company had no obligation to advance fees to a former board member who had filed a lawsuit against the company following his removal for cause from the board.

Delaware General Corporation Law Section 145 gives a Delaware corporation the power to indemnify and provide advancement of attorneys' fees to its officers, directors, employees or agents. While the advancement authority in Section 145 is permissive, many corporate bylaws or articles of incorporation contain mandatory advancement provisions and, as the three new decisions show, it is the specific wording of the bylaws that often dictates just who is (or is not) covered for advancement of fees.

Outside Litigation Counsel Is Company's Agent to Whom Fees Must Be Advanced

Vice Chancellor Parsons held that Spira Footwear, Inc. had to advance fees to its prior outside litigation counsel in *Jackson Walker v. Spira Footwear, Inc.*, 2008 WL 2487256 (Del. Ch. June 23, 2008). The specific facts of this case, which led to Spira suing Jackson Walker for breach of fiduciary duty after Jackson Walker had represented Spira in prior litigation, are not likely to be often duplicated. The case does open the door, however, for outside litigation counsel, and possibly other consultants or service providers of a company, to seek and be granted advancement of fees where the relationship has soured into litigation. The underlying litigation was among the shareholders of Spira for control of the corporation, and Jackson Walker represented Spira in the litigation at a time when the former majority shareholders controlled the company. Following the conclusion of that litigation, the challenger shareholder acquired control of Spira, fired Jackson Walker as Spira's counsel and filed an action against Jackson Walker on behalf of Spira for breach of fiduciary duties and negligence. In addition to suing Spira in Texas state court to collect on outstanding invoices, Jackson Walker sought advancement of its fees incurred in defense of the lawsuit filed against it by Spira.

Spira's bylaws stated that expenses, including attorneys' fees, incurred in defending a civil or criminal action "shall be paid" by Spira in advance of the final disposition of the action on behalf of "the Director, officer, employee or agent." The only issue was whether Jackson Walker qualified as an "agent" under Spira's bylaws, and the court held that it did. Relying on a 2003 Delaware Chancery Court opinion that an agent was someone who acted on behalf of a company in relations with third parties, the court held that Jackson Walker, in its role as litigation counsel to Spira, acted on behalf of Spira in relations with third parties and those were the actions for which Spira was suing Jackson Walker. Noting that Section 145 should be broadly interpreted, the court held that Jackson Walker was therefore an "agent" for purposes of advancement of fees.

The court clarified, however, that attorneys would not be considered agents under Section 145 when the attorneys performed only corporate/transactional work or other similar advisory work where they did not interact with third parties on behalf of the company. Importantly, no fees would be advanced under Section 145 for an action by the company against the attorneys for legal malpractice.

Company Cannot Withhold Advancement of Fees Due to Disagreement with Directors' Settlement Posture

Barrett v. American Country Holdings, Inc., 951 A.2d 735 (Del. Ch. June 20, 2008), decided by Vice Chancellor Strine, took American Country Holdings to task for withholding advancement of fees to its former directors. American brought an action against its former directors for securities fraud, and the applicable directors and officers' insurance policy initially covered the former directors' fees. Once the insurance policy limits were exhausted, the former directors brought the subject action for advancement of fees. American refused to advance fees because the directors rejected settlement proposals in the underlying securities litigation, which would require the entry of judgment in favor of the company and assignment of any rights the former directors had against the insurer. Because American told the directors it would not collect on the judgment, American argued that the former directors forfeited their right to advancement by unreasonably refusing settlement. The Delaware Chancery Court soundly rejected American's argument.

American's charter required that the company advance legal expenses to former officers and directors "to the fullest extent permitted by … Section 145." The court held that under Section 145, the company was "not free to withhold advancement from the Former Directors as some form of pressure strategy to extract assignments, judgments, breaches of contract, and pledges of cooperation from them." Therefore, a company must advance fees to its directors, even if it has brought an action against them for securities fraud, and even if it does not like the position the directors are taking in defending the action, under Section 145, unless otherwise limited.

Advancement of Fees for Defense of Action Does Not Extend to Action Filed By Former Board Member Against Company

In *Donohue v. Corning*, 949 A.2d 574 (Del. Ch. June 20, 2008), Vice Chancellor Strine interpreted Expansion Capital Partners, LLC's advancement of fees provision that Expansion would advance fees "incurred in connection with the defense or disposition of any claim, action, suit, or proceeding, whether civil, criminal, administrative or investigative, in which the Covered Person is involved, as a party or otherwise, or with which the Covered Person may be threatened …," holding it did not cover advancement of fees for an action filed by a former

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Advance Fees

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board member against Expansion.

Donahue, the former managing partner of Expansion, was removed for cause by a vote of the non-managing members on Expansion's board. Donahue then filed litigation against Expansion to determine the control of Expansion, and sought advancement of his fees in the case he initiated. The court rejected Donahue's argument that he was bringing the litigation for the benefit of the investors, noting the issue was not for whose benefit the underlying litigation was brought, but whether the litigation fell under the contractual language of the applicable advancement of fees provision.

Donahue also argued that he was "threatened" to be removed for cause and his lawsuit addresses that threat, but the court determined that a cause of removal is not a "proceeding" as contemplated by the advancement provision. Because "Expansion has nearly unfettered contractual discretion in determining whether to grant advancement, Donohue must establish that he is entitled to advancement under the terms of Expansion's Advancement Provision itself." In the court's view, the best reading of the advancement provision is that "it only provides advancement to a person covered by that provision who is in a defensive posture, in the sense of responding to an action or other proceeding relating to his official capacity." The court therefore strictly applied the terms of the relevant advancement provision limiting advancement to defensive proceedings.

Is It Time to Update Your Advancement of Fees Provision?

While companies could arguably delete a mandatory advancement of fees provision completely, the absence of any mandatory provision could make it hard for the company to recruit capable directors and officers. Instead, all three Delaware Chancery Court decisions emphasize the importance of tailoring and limiting the specific language contained in advancement of fees provisions.

A logical reaction to *Jackson Walker* might be to delete "agent" altogether from the list of those for whom the company must advance fees, and for some companies that works. There are, however, valid reasons for companies to keep the reference to agent in their bylaws. For example, a company may normally retain consultants who are acting as the company's agent, and for whom the company does intend to advance fees if the consultants are sued for their work at the company. A better solution, therefore, is to clarify the bylaws, to specifically state that "agent" does not include attorneys, auditors, or other service providers.

Jackson Walker provided companies with another option to ensure against advancing fees to their outside litigation counsel, when it commented that "courts should be reluctant to interpret § 145 and bylaws that implement it as displacing the more specific contractual arrangements that are typically drafted between corporations and outside contractors, such as attorneys, investment bankers, engineers, and information technology providers." Therefore, as long as the contract between the company and the outside contractor/service provider specifies that the company will not advance fees to those outside contractors, the contracts will trump the company's bylaws. The best time to negotiate this type of language with attorneys or other service providers is at the beginning of the relationship, before the relationship deteriorates to the point that it had in *Jackson Walker*.

If not already included, *Donohue* supports including a "defensive" limitation in the fee advancement provision, as a way of ensuring that no covered persons can seek advancement of attorneys' fees from the company for actions they have affirmatively filed against the company. While most directors and officers seeking advancement of fees are defendants, including a defensive limitation on the advancement of fees obligation covers situations such as in *Donohue*, where there is a corporate control or corporate governance dispute, and should also stop covered persons from using the advancement of fees provision when they file other types of litigation, such as employment disputes.

Finally, *Barrett* suggests that a company consider whether to include limiting language so that the company does not have an obligation to advance fees to covered persons when the company itself has brought the action against the covered person. With such a limitation, fees would still be advanced in an action filed by a shareholder or other third party, but not in actions filed directly by the company. At the least, companies should understand that a grant of advancement of fees "to the fullest extent permitted by Section 145" or "to the fullest extent permitted by law" is very broad, and does cover actions by the company against the officer or director, with no exceptions.

Conclusion

Donohue recognized that companies have "nearly unfettered contractual discretion in determining whether to grant advancement." Delaware companies should ensure they are exercising this discretion to their benefit before a situation arises, rather than being surprised as to when they must advance fees. These cases do not automatically support revised advancement of fees provision. Instead, a company should review its advancement of fees provision to determine whether a revision to the advancement of fees provision could limit the company's obligation to advance fees in the future, rather than blindly copying the broad language from Section 145 or a form advancement of fees provision.

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Supreme Court

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The far more thoughtful approach would be to view low ratios, such as 2:1, 3:1, and so on, as alive and well. The 1:1 of *Exxon* should be viewed as having limited traction. Defending against punitive damages claims should therefore be mounted as strongly as ever, to ensure that a finder of fact is dissuaded from going to the high end of the approved scale, let alone find the exceptional circumstances that might justify a punitive award in the double digit ratio territory.

CONCLUSION

In conclusion, the Supreme Court did pay attention to business cases this year. In an act of utter reliability, it stuck to *stare decisis*, and found a statute and its history broad enough to encompass retaliation claims where race discrimination is alleged. This may open businesses to more litigation on such claims, but the result cannot be called a surprise, given its reliance upon known precedent. Given the heightened risk, businesses would be well advised to adjust their internal policies to ensure the circumstances that might give rise to such wrongdoing do not arise in the first place.

In revisiting punitive damages, the Court seems to have added a note toward keeping them minimal, but that would be a superficial assessment. Much better to say this was an exceptional case from a narrow field, and the Court was greatly swayed by the gargantuan damages already paid. The latter, more than anything, probably influenced the Justices to adopt a 1:1 ratio, so as to avoid burdening the defendant with a grossly excessive, and thus constitutionally defective, judgment. It would be a serious mistake to read *Exxon* as the advent of a 1:1 ratio for punitives. Single-digit ratios, including as high as 9:1, are still viable; therefore, it is much better to work actively to deny a jury any basis to venture into such dangerous territory. And better still for any business to have policies in place that make it clear that such retribution is unnecessary.

The Supreme Court has spoken; now it's time for American businesses to listen Until this time next year, we trust you will be listening carefully.

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Business Judgment

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decision to "just say no" to the First Place bid. In contrast to situations where a board of directors takes defensive measures to repel a hostile takeover attempt or engages in conduct geared to entrenching their corporate positions, the decision of the First Niles directors to reject the First Place (and other) bids was afforded the protection of the business judgment rule. This result should be of comfort to corporate directors who, when confronted with an unsolicited merger proposal or a decision whether or not to proceed with a sales process, understand that they can pursue other strategies for the company without being second-guessed, as long as they can demonstrate that they exercised due care in reaching their decision and were not subject to a disabling conflict of interest.

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Former Employee

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the former employee a fee to compensate him for his time. It should instruct the former employee that he should not allow the fee to influence the substance of his testimony. Of course, this fee agreement will be discoverable and you should instruct your former employee to testify candidly about it at his deposition.

CONCLUSION

A former employee can be a pivotal witness for your company. Fortunately, the ethics rules permit you to help your former employee by alleviating some of the hardships of testifying. If a former employee wants counsel, you can provide it. If he wants to be compensated for his time, you can do that, as long as the fee is reasonable. But you cannot discourage him from cooperating with your opposing counsel, if he chooses to do so.

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