Lavish Severance Amid 'Credible' Allegations?

By Jennifer Williams-Alvarez February 25, 2019

Faced with allegations that executives have engaged in or enabled sexual misconduct, directors face a number of decisions, including whether the individuals should be terminated and if a payout, such as for a severance agreement or accelerated stock award, should be made.

Recent examples have shown that parting ways while handing executives multimillion-dollar checks has not proven to be a popular move. At **Alphabet**, for example, an explosive report late last year from *The New York Times* detailing the exit packages paid by Google to executives accused of misconduct led to an employee revolt. Additionally, the backlash has included shareholder derivative suits against directors, in part for making payouts to executives who were "credibly" accused of sexual harassment, according to one suit. One such payment was reportedly worth $90 million.

"Directors, as fiduciaries for the company, can't reward violators of the law," says **Julie Goldsmith Reiser**, an attorney representing the plaintiffs in one of the suits against Alphabet directors, pointing to Title VII of the Civil Rights Act. "And $90 million for somebody who was credibly accused of sexual harassment is an outrageous sum of money."

Moreover, she says, the payouts put the company at risk for litigation.

Conversely, directors are given broad discretion by courts to make business decisions, including on how to handle executives' exits. This may include contemplating what will assist the company in moving beyond a scandal or preventing an executive from going to a competitor, sources say. Similarly, contractual obligations may limit directors' discretion in deciding not to pay those accused of misconduct.

"A decision by the board of directors, depending on the context, to pay an alleged wrongdoer to reach an amicable separation does not reflect condoning the conduct," says **Lewis Lazarus**, partner at law firm **Morris James**. "It reflects an iteration of the larger interests of the company as a whole and what may be required so that they can move forward and generate value for their stockholders," adds Lazarus, who spoke generally and not about specific companies.

Recent Lawsuits

Alphabet directors were hit with two derivative suits early this year that claim directors breached their fiduciary duties in approving excessive payouts to executives who allegedly engaged in misconduct. In the case of former Google senior vice president **Andy Rubin**, the complaints recount details reported by the *Times,* such as an accusation by an employee who said that in 2013, she had been coerced by Rubin into performing oral sex. This employee filed a complaint the following year, which prompted an investigation that reportedly found the claim to be credible.

Instead of being fired for cause, Rubin, who created the company's Android mobile software, walked away with $90 million, to be paid out over a period of four years, according to the *Times*, citing two people with knowledge of the terms. Rubin could not be reached for comment. He denied coercing a woman to have sex after the *Times*' article was published.

Another executive, senior vice president **Amit Singhal**, similarly walked away with a multimillion-dollar exit package after a claim that he had groped an employee was found to be credible, the *Times* reported.

Directors breached their fiduciary duties in approving these payouts to individuals who should have been terminated for cause and perpetuated a culture of concealment, one of the complaints reads. Neither the company nor its comp committee directors responded to requests for comment. Directors have not yet filed responses to the complaints.

In separate litigation, **Nike** directors have been hit with a derivative suit in the wake of allegations that a so-called "boys' club" culture within the company resulted in gender discrimination and sexual harassment. An unredacted complaint filed in a circuit court in Multnomah County in Oregon claims directors "indiscriminately approved excessive compensation packages and generous severance payouts to executives, including those who were directly and actively involved in the creation of a hostile work environment at Nike."

The complaint points to former Nike brand president **Trevor Edwards**, described in the suit as "one of the ringleaders of the wrongful conduct occurring at Nike," as an example of an individual who left his role amid scandal with a healthy payout. Edwards was not terminated for cause and received a $525,000 payout and nearly $9 million in unvested stock awards, according to the filing.

The directors hit back in a motion to dismiss, arguing, among other claims, that the very policies and procedures plaintiffs cite in the complaint prove that directors did not abdicate their responsibilities. In an e-mail comment to *Agenda,* a Nike spokesperson says the board will "vigorously" defend against the allegations in the complaint and that directors "acted swiftly, responsibly, and decisively to protect the interests of both Nike employees and shareholders."

Attorneys representing plaintiffs in these cases question the implications of these payments in interviews with *Agenda*. Reiser, a partner at firm **Cohen Milstein Sellers & Toll**, says paying executives and allowing them to walk away in circumstances like those alleged in the Alphabet complaint not only protects someone who has put the company legally at risk, but also feeds into the notion employees may have that they are not safe in speaking out.

For **Gustavo Bruckner**, an attorney representing plaintiffs in the Nike suit and a partner at firm **Pomerantz**, there should be no gain from misconduct. "It is a basic tenet of corporate law that one cannot profit from wrongdoing," he writes in an e-mail. "Edwards should not be allowed to walk away with tens of millions of dollars in compensation after having caused the premature end of dozens of careers of talented female employees. It cannot be that the victims get nothing while the perpetrator is rewarded handsomely."

Blowback From Multiple Parties

Bruckner rejects the idea that having an exec end up at a competitor is persuasive motivation for a payout. “Someone terminated for cause for their role in fostering a hostile environment is not going to be marketable, and corporate boards should stop fearing that they will end up at a competitor company,” he writes.

But payouts may be seen as a way to limit the damage associated with an executive’s bad acts, including a fear that he or she will go to a competitor, sources say.

First and foremost in these considerations is an executive’s employment contract, which would define when an individual can be fired for cause, says **John Stout,** shareholder at law firm **Fredrikson & Byron**. From there, multiple factors can be folded into the decision, one of which is the likelihood that an executive will contest the details surrounding their exit, he says.

Barnes & Noble, for example, faces a suit following the termination of former CEO **Demos Parneros**, who was fired without severance. In a complaint last year, Parneros accused the bookseller of firing him without justification.

Speaking generally, Stout says common sense would dictate that directors should have the right, and may even feel a responsibility, to get rid of an executive who has damaged the company, but it may come down to a question of whether to move forward or fight about pay.

“Public opinion is going to be disgusted,” Stout says, “and yet your fiduciary responsibility may require that you look at this and say, you know what, the best interest of the company is to pay it and get the hell out of here.”

A board’s relationship with the outgoing CEO and a potential desire to limit where he or she can go after departure are two factors that may also motivate a board’s decision, says **Mike Melbinger**, a partner with **Winston & Strawn**, who spoke generally. No matter the rationale, though, Melbinger says boards would be wise to carefully document the justification behind the choice.

“The first thing is, must they make the payout, because if there’s a way to avoid it, they need to consider it,” he says. “And whether they pay out or they don’t pay out, they better create a very clear paper trail showing that they seriously considered this issue with the advice of outside experts and made a reasoned decision.”

The suits against Nike and Alphabet directors follow a long line of court decisions that have protected directors when it comes to decisions about pay, even in questionable circumstances or amid scandal. In 1998, a shareholder filed a derivative suit against directors at a company called ICN Pharmaceuticals. **Milan Panic**, the founder and then-CEO of the company, was claimed to have been accused of several counts of sexual misconduct or harassment, with some of these instances resulting in lawsuits. While the board increased Panic’s salary and allegedly paid millions to settle harassment suits, the **Delaware Chancery Court** and then the **Delaware Supreme Court** in 2001 found the complaint did not raise reasonable doubt that directors’ actions were “the product of valid business judgment.”

And this month, the Chancery Court granted a motion to dismiss a derivative suit against current and former directors of **United Continental Holdings**, who were described in the complaint as having granted “lavish golden parachutes” to senior executives known to have been involved in a bribery scheme.

Sources agree that the threshold is high for the court to find directors breached their duties. Reiser believes, however, that the desire for accountability may soon reach the courts. “I believe there is more of a sense that people who were complicit in helping cover it up need to be held accountable,” she says. “The law is hard in these cases, but I think public opinion has come around in a way that courts are also now going to come around.”

To this point, courts have largely avoided making bold determinations in how boards should react to misconduct claims, and whether to pay severance, says **Gregory Shill**, associate professor of law at the **University of Iowa** College of Law. “That’s a decision that is primarily governed by business considerations, and courts wouldn’t see themselves as the primary venue for resolving it,” he explains.

But this is the type of issue that is likely to trigger passionate reactions, he says. “If you’re cutting a check to an executive … and that person did something wrong, maybe illegal, that kind of thing has kind of grown in a lab for virality,” says Shill.

“Observers here [are] not predisposed to be sympathetic to the corporation.”