KUTAK ROCK LLP

# CORPORATE NOTES

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Happy 4th of July!

# SUPREME COURT ALLOWS EMPLOYER DEFENSE IN SEX HARASSMENT CASE

*Alan Strasser of our Washington, DC office writes:*

The US Supreme Court last week preserved for employers the ability to use an affirmative defense in a sexual harassment case where an employee quits his or her job in response to a hostile work environment without first taking advantage of the company's internal reporting mechanism.

The Court noted that a resignation because of sexual harassment is a "constructive discharge" of the employee if working conditions are "so intolerable that a reasonable person would have felt compelled to resign." And, the employer may be liable if the constructive discharge - which may have the same effect as a firing - follows an "employer-sanctioned adverse action" that changed the employee's status or situation. Examples of such employer action include "a humiliating demotion, extreme cut in pay, or transfer to a position in which she would face unbearable working conditions." (*Pennsylvania State Police v. Nancy Drew Suders,* 542 US __ (2004))

In this case, a woman was hired at a state police barracks to handle radio calls. She was supervised by three male state police officers, who subjected her to a "continuous barrage of sexual harassment that ceased only when she resigned from the force" five months later. During that time, she complained twice to the EEO officer but no action was taken. She resigned immediately after being falsely accused of stealing internal documents. She later sued the state police for sexual harassment. The state police argued that her resignation was not an action by her employer and therefore did not prevent the state police from asserting a two-part affirmative defense first outlined by the Supreme Court in 1998.

This two-part defense allows an employer to avoid liability if it can show that (i) it had a policy and mechanism in place for reporting and resolving sexual harassment claims, and (ii) the employee claiming harassment unreasonably failed to use that process. However, an employer could not use this defense if it took "tangible employment action" against the employee, such as a "firing, demotion, or undesirable reassignment." The Third Circuit held that this affirmative defense was also not available in a constructive discharge case.

The Supreme Court disagreed with the Third Circuit and held that while a constructive discharge may have the same effect as the firing, it does not prevent an employer from using the two-part defense if the constructive discharge did not follow a change in the employee's status or situation.

**This ruling highlights the need for a company to ensure that it has in place an effective mechanism for detecting sexual harassment, so that it can avoid putting itself in the circumstances where a change in an employee's status prompts the employee to quit and file sexual harassment**

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**charges even though the employee had never reported them within the company.**

## ■ COURT: YOU CAN'T SUE IF YOU DON'T OWN THE SECURITIES

When material misrepresentations made by another company negatively impact purchasers of your stock, may your stockholders sue the other company for securities fraud under Rule 10b-5 of the federal securities laws? The US Court of Appeals for the Second Circuit recently said no.

In the case, Nortel Networks planned to purchase JDS Uniphase's laser business in exchange for $2.5 billion in stock and a promise of increased purchases. Based on Nortel's offer and its announcement of increased demand and earnings, the stock prices of both companies rose significantly. Nortel later announced a $1.7 billion reduction in its estimates of revenue for the quarter and also a 50% decline in revenue growth, causing a drop in its stock price and that of JDS. A stockholder of JDS sued Nortel, claiming that Nortel's earlier announcements about its future prospects was materially misleading and seeking damages under Rule 10b-5.

**The court found that a stockholder may only sue for personal damages under the SEC's Rule 10b-5 if the stockholder actually owns the stock of that company. Thus, the JDS stockholder's lawsuit against Nortel based on a violation of Rule 10b-5 was dismissed.**

## ■ SECRET MERGER NEGOTIATIONS MAY NEED TO BE DISCLOSED

A recent Delaware case held that a company's negotiations to sell its business may need to be disclosed if it is material to a stockholder's decision to take advantage of the company's targeted buy-sell program.

In the case, a company announced that it would offer to buy or sell shares at market value to stockholders with less than 100 shares. The buy-sell program reduced the transaction fees for participating stockholders. During the course of the buy-sell program, the company was secretly negotiating its possible sale to another company for a substantial premium per share over the market value.

A stockholder that sold her stock in the buy-sell program sued the board of directors for breach of fiduciary duty for failing to disclose the negotiations. In allowing the lawsuit to go forward, the Delaware court noted that although a case upon which the company relied did not require disclosure, it only involved "certain casual inquiries" about a subsidiary that was not for sale and was subsequently merged into the parent. Here, the Delaware court found that many of the deal terms had been agreed upon and the negotiations were in an advanced stage. Therefore, the Delaware court ruled that the structure of the proposed deal was sufficiently firm to require disclosure of the negotiations in light of the ongoing buy-sell program.

**Companies should consult their corporate counsel regarding the potential disclosure of material information prior to the commencement of a buy-sell or stock repurchase program.**


Kutak Rock LLP is a national law firm with 325 attorneys located in 16 offices throughout the United States. Our practice includes corporate, banking and federal securities law, mergers and acquisitions, bankruptcy and creditors' rights, executive compensation, and complex commercial litigation.

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