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Puffery or Not? Courts Examine Corporate Codes of Conduct

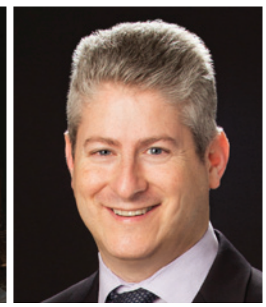
BY SARAH LIGHTDALE, IAN SHAPIRO AND LINH NGUYEN

In recent months, securities complaints alleging that a company has made false or misleading statements in or about its code of conduct have been on the uptick. In the wake of *Singh v. Cigna Corporation*, a 2019 Second Circuit opinion that conclusively found statements in a code of conduct to be non-actionable, plaintiff's counsel have been undeterred. And for good reason: federal courts after *Singh* have found statements in or about a company's codes of conduct to be material enough to be actionable, including, in some instances, boilerplate aspirational statements generally thought to be textbook puffery. Signet Jewelers Ltd., for example, recently reached a $240 million settlement with plaintiffs in a securities class action after a New York federal judge found that statements in Signet's Code of Conduct could be materially false or misleading.

SARAH LIGHTDALE *is securities litigation partner at Cooley.* IAN SHAPIRO *is a partner and head of Cooley's business litigation for the East Coast.* LINH NGUYEN *is an associate at the firm. Cooley partners* PATRICK GIBBS, KOJI FUKUMURA *and* RYAN BLAIR *contributed to the preparation of this article.*

However, it is not all bad news. A number of federal courts have followed *Singh* and found code of conduct statements to be non-actionable puffery. A comparison of the cases provides valuable guidance. Given the uncertainty in the face of the novel coronavirus pandemic, public companies should review their codes of conduct and revise them if necessary to mitigate future litigation risk due to the current environment.

Sarah Lightdale



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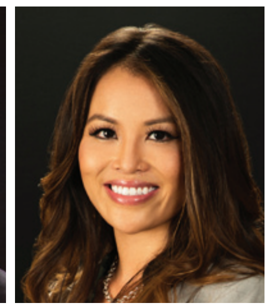

Linh Nguyen

Background

As you may recall, in *Singh*, plaintiffs alleged that Cigna made misleading statements by publishing its Code of Ethics, which stated, among other things, "it's so important for every employee…to handle, maintain, and report on information in compliance with all laws and regulations," and included statements from senior executives affirming the importance of compliance and integrity. At the same time, plaintiffs alleged Cigna, a multinational health organization, was experiencing a series of regulatory compliance failures in its Medicare operations, which rendered its code statements misleading.

Judge Vanessa L. Bryant, of the federal district court in Connecticut, disagreed and held that, among other things, the code statements "reflect the precise meaning" of puffery. Importantly, the court noted that the plaintiffs did not allege at what point the executives made the statements quoted in the Code of Ethics. Thus, the executives "could have uttered these words years before they were actually published," which meant the statements might not have been false when made.

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In March 2019, the U.S. Court of Appeals for the Second Circuit unanimously affirmed the district court on appeal. According to the Second Circuit, Cigna's statements in its Code of Ethics amounted "to general declarations about the importance of acting lawfully and with integrity" on which no reasonable stockholder would rely.

Southern District's Mixed Bag

Judge Colleen McMahon, in the Southern District of New York, later clarified *Singh* with *In re Signet Jewelers Limited Securities Litigation*. There, plaintiffs alleged that statements in the jewelry company's Code of Conduct explaining that Signet made employment decisions "solely" on the basis of merit, and was "committed" to a workplace "free from sexual, racial, or other unlawful harassment," were false and misleading given the pervasive sexual harassment and discrimination occurring even at the highest levels of the company. Using *Singh*, the Signet defendants asserted that, as a rule, code statements are never actionable because they are too general to be relied upon.

Judge McMahon disagreed, noting *Singh* did not rule that all statements in codes of conduct qualified as puffery. Instead, the *Singh* court expressly stated that "context" bears on materiality. The *Singh* code statements, according to McMahon, were "exceptionally vague and aspirational" and were not related to bad acts alleged in that case.

In contrast, the Signet code statements were directly at odds with the plaintiffs' allegations that Signet suffered from rampant sexual harassment and discrimination. And, in the face of credible sexual misconduct claims, the Signet defendants reassured investors by pointing to the Code of Conduct as a way of reaffirming their commitment to holding senior executives accountable. McMahon concluded that in this context, such statements in the Code of Conduct could materially mislead a reasonable investor who might otherwise be concerned about the grave allegations of sexual misconduct at Signet.

By comparison, Judge Valerie Caproni, also in the Southern District of New York, cited *Singh* and *Signet* to conclude that the code of conduct statements before her were textbook puffery. In *Construction Laborers Pension Trust for Southern California v. CBS Corporation*, the plaintiffs alleged that Les Moonves, the CEO of CBS and Chairman of the Board of Directors, engaged in sexual misconduct for years while at the helm of the company.

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The plaintiffs' theory of the case was that this allegedly made CBS susceptible to losing its star executive to a sexual harassment lawsuit, an acute risk in the era of #MeToo that was undisclosed by the company. Plaintiffs asserted that as a result of Moonves' and other managers' sexual misconduct, statements in CBS's Code of Conduct, such as CBS "believes in an environment that is free from workplace bullying," has a "zero tolerance policy for sexual harassment," and "will take reports of violation or suspected violation of these policies very seriously," were

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false and misleading. The district court disagreed:

> These statements were not made to reassure investors that no CBS executive, or its CEO specifically, was susceptible to being the target of accusations of sexual harassment. Nor do they describe concrete steps taken by the Company to ensure compliance with internal policy or the law. Nor is the alleged misconduct, although reprehensible, alleged to be so pervasive that the Amended Complaint has plausibly alleged that CBS, in fact, held none of its asserted aspirations. In short, most statements in the [Code of Conduct] are mere puffery.

Even code statements that were "close to being statements of fact," such as CBS "'will' take 'all steps' and 'remedial action' to stop 'sexual harassment,'" were "too general and disconnected from plaintiffs' central theory of securities fraud to be material." According to Judge Caproni, "[n]o reasonable investor would rely on these statements as assurance that CBS had no high-level executive who was vulnerable to a #MeToo moment."

Moreover, the company's description of its Code of Conduct in its SEC filings made clear that the Code set forth "standards" for ethical conduct, and addressed a "general obligation" to promote honest and ethical conduct within the company. This underscored the "generic and aspirational nature" of the statements contained within the Code.

Following in the footsteps of *CBS*, Judge Kimba Wood in the Southern District of New York similarly found code statements non-actionable in *Oklahoma Law Enforcement Retirement System v. Papa John's International, Inc*. There, the plaintiffs alleged that the company's Code of Conduct was false and misleading because former executives, including John Schnatter, the founder and Chairman of the Board of Papa John's, were enabling and perpetuating workplace sexual harassment.

Judge Wood, however, concluded that Papa John's Code of Conduct included the same type of "broad, aspirational, and vague" statements found immaterial in *CBS*. For example, the Code required employees to exhibit the "highest ethical standards," be guided by "principles of honesty, fairness, [and] mutual respect," and should ensure a working environment "free of harassment or other intimidating, hostile or offensive behavior."

Notably, the Code failed "entirely to elaborate on what exactly the company would do to prevent or respond to workplace sexual harassment." Also, as in *CBS*, there was "no allegation that the company highlighted its [Code] in the wake of revelations about workplace sexual harassment to reassure investors that [it] would not be rocked by similar allegations against its executives." The court continued:

> The fact that defendants regularly claimed that its culture and reputation were key to its success does not alter this conclusion. *The importance of [a company's] culture and reputation to its success does not mean that any statement lauding these intangibles was material under the securities laws.* Rather, the relevant inquiry must consider whether the statement made was sufficiently specific that a reasonable investor could rely on it as a guarantee of some concrete fact or outcome. The statements in the Code were not.

Lessons to Be Learned

So-called "event-driven" federal securities lawsuits—i.e., lawsuits that arise out of unrelated legal and compliance issues—that target statements in or about a company's code of conduct or ethics are on the rise. Public companies should be mindful of this trend and review their codes of conduct, related statements to the market and internal controls and procedures accordingly.

Federal courts are less likely to credit a code-of-conduct-based theory of securities fraud where:

- The code of conduct contains broad and aspirational statements describing a company's ethical goals;
- The code of conduct sets out standards or guidelines for employee behavior, as opposed to mandatory rules; and
- Statements surrounding or about the code of conduct emphasize its aspirational nature.

But most importantly, as in the traditional materiality analysis, *context matters*. As the *Signet* court stated, "[w]hile generalized, open-ended or aspirational statements do not give rise to securities fraud (as mere puffery), statements contained in a code of conduct are actionable where they are directly at odds with the conduct alleged in a complaint." Public companies that could potentially have recurring employee issues given the nature of its business might consider including a risk factor.

In the wake of the novel coronavirus pandemic, it is especially important for public companies to keep these lessons in mind and put them to use. *Public companies can become vulnerable to claims regarding their codes of conduct in the face of rapidly changing social or economic conditions.* To mitigate the risk, a public company that potentially has recurring employee issues given the nature of its business might consider including a risk factor in its regulatory filings acknowledging the possibility that employees might violate the code of conduct and, if they do, it could have serious adverse consequences for the company.

Such a disclosure could have been helpful, for example, in a recent case filed against a cruise line, in which plaintiffs allege the company encouraged employees to mislead potential customers about how the novel coronavirus might affect the cruises they were about to book. Such conduct, plaintiffs assert, violated the company's Code of Ethical Business Conduct.

Specifically, plaintiffs allege it violated the section stating that company employees are "expected to conduct business in compliance with applicable environmental, health and safety laws and regulations[,] [which] are designed to ensure the preservation of the environment, and safety and security of [the company's] guests, team members and vendors." Whether a court will find that code section itself to be an actionable misstatement based on those facts remains to be seen. But what looks like a near-certainty, in this environment of unprecedented business disruption, is that similar claims will continue to be made.