March 2014

Dear Clients and Friends:

We hope that your businesses have gotten off to a strong start in 2014. We write to update you on recent and pending changes in the law that present new and exciting opportunities for both small businesses engaged in capital raising and for those interested in incorporating or investing in a for profit business venture created for the purpose of serving a public good. We also shine a light on an employment law-related business trap for the unwary.

In our first article, we discuss final rules forthcoming under the Jumpstart Our Business Startups Act (JOBS Act) that will allow small businesses to raise capital from individual investors through the internet through the use of "crowdfunding." In our second article we discuss changes to the Delaware General Corporate Law which permit the incorporation of "Public Benefit Corporations" allowing for-profit corporations to be organized for "public benefit" purposes. In our last piece, we look at the role of "supervisors" in the employment law context and discuss how supervisors in an organization can create employer liability resulting from employee harassment claims.

For further information about these issues or our Private Companies group, please contact any of the authors listed below or your Schiff Hardin attorney, or visit www.schiffhardin.com.

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Crowdfunding under the JOBS Act

Under Article III of the JOBS Act, certain startups and small businesses will be able to raise capital by selling their securities online through a qualified funding portal.

"Crowdfunding" is an exciting and news-generating part of the Jumpstart Our Business Startups Act (the JOBS Act) that was enacted on April 5, 2012. Congress, through the JOBS Act, created a crowdfunding exemption from when the offer and sale of securities must be registered with the Securities and Exchange Commission (SEC). In February, and almost two years after the JOBS Act was enacted, the public comment period on the crowdfunding rules proposed by the SEC ended. While we wait for the final rules, it is worth noting what crowdfunding is as well as some of the key proposed rules governing who may sell and buy these securities.

Offering and selling securities through crowdfunding is an extension of the already prevalent use of the internet to raise money for causes, ideas, and organizations through platforms such as Kickstarter. Under Article III of the JOBS Act, certain startups and small businesses will be able to raise capital by selling their securities online through a qualified funding portal. It is hoped that crowdfunding will benefit startups and investors by introducing a wide array of investors to startups and vice versa.

According to the JOBS Act, proposed rules and the SEC's press release entitled "SEC Issues Proposal on Crowdfunding," a company may raise up to one million dollars through offering and selling securities through crowdfunding in a 12-month period. Additionally, an individual investor whose annual income and net worth are less than $100,000 may only invest the greater of $2,000 or five percent of his or her annual income or net worth in any 12-month period. For investors with an annual income or net worth equal to or greater than $100,000, they may, in any 12-month period, invest 10 percent of their annual income or net worth, whichever is greater, not to exceed $100,000.

There are also several limitations regarding the type of companies that may participate in crowdfunding to offer and sell securities. Two such limitations are that non-U.S. companies and companies that already report to the SEC may not participate. Eligible companies that choose to participate in crowdfunding must comply with numerous reporting and regulatory obligations. For example, there are requirements for the offering documents that must be provided to the SEC, potential investors, and the intermediary facilitating the crowdfunding as well as annual report requirements that vary based on the amount of capital being raised.

The actual investing must take place online through a qualified SEC-registered intermediary, either a broker-dealer or a funding portal, which is a new type

of SEC registrant. The proposed rules set forth several obligations on these intermediaries such as providing certain information about an issuer and an offering, providing investors with certain educational materials, and taking measures to reduce the risk of fraud.

While the final rules and ultimate compliance costs for participating companies and intermediaries are not yet certain, crowdfunding will be a valid and potentially attractive option to several startups as well as investors and would-be intermediaries.

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Delaware Introduces Socially Conscious Corporations

PBC affords operational flexibility for entrepreneurs and investors wishing to pursue public interests through a for-profit business entity in Delaware

On Aug. 1, 2013, significant amendments to the Delaware General Corporation Law went into effect. Following in the footsteps of a handful of other states, new Subchapter XV of the Delaware General Corporation Law provides for the formation of public benefit corporations (PBC). A PBC is a for-profit corporation that must simultaneously manage (1) its stockholders' pecuniary interests, (2) the best interests of those materially affected by the PBC's conduct, and (3) the public benefit identified by the PBC in its certificate of incorporation. A PBC may provide the means for organizing a for-profit business venture that actively promotes a public benefit without necessarily requiring the directors of the corporation to maximize the stockholders' pecuniary interest in the corporation. A PBC may be particularly attractive to an investor base that seeks both social and economic returns on their investment.

Purpose and Balance

Two of the key requirements of the PBC statute are the "public benefit" purpose requirement and the balance of interest requirement. The certificate of incorporation must include the purpose of the PBC and must promote one or more specific public benefits. "Public benefits" are broadly defined to include positive effects (or a reduction of negative effects) on persons, entities, communities or interests of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature. In terms of the balance of interest requirement, the PBC must be managed in a way that balances the stockholders' pecuniary interests, the interests of those materially affected by the corporation's conduct, and the public benefit identified in the certificate of incorporation.

Fiduciary Duties

The directors of a PBC must manage the business and affairs of the corporation in a responsible and sustainable manner, balancing the interests of the corporation's stakeholders. While it is the board's responsibility to make these balancing decisions, the directors do not owe any duties to non-stockholders. Directors will be deemed to satisfy their fiduciary duties to both stockholders and the corporation if a decision by the directors is informed and disinterested. Further, directors will benefit from the business judgment rule if stockholders challenge a disinterested balancing decision. Only stockholders owning a material stake in the corporation may bring a derivative suit to enforce the balancing requirement.

Transparency and Reporting

PBCs must provide periodic reports to stockholders at least every two years regarding the corporation's performance in promoting the public benefits identified in its certificate of incorporation. These reports must include the following four items:

1. The objectives that the board of directors of the PBC established to promote such public benefits and interests;
2. The standards the board of directors of the PBC adopted to measure the PBC's progress in promoting such public benefits and interests;
3. Objective factual information based on those standards regarding the PBC's success in meeting the objectives for promoting such public benefits and interests;
4. An assessment of the PBC's success in meeting the objectives and promoting such public benefits and interests.

The Takeaway

Civic minded entrepreneurs and socially responsible investors may wish to consider the operational flexibility that a PBC affords them to pursue public interests through a for-profit business entity in Delaware, but they will need to weigh this consideration against their expectations for economic returns.

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Do You Know Who Your "Supervisors" Are? The Answer May Surprise You

Supervisors can have a critical role in determining employer liability for employment-related claims

In most companies, supervisors wear many hats. It is important to remember that, in additional to the important roles they play in facilitating business operations and managing personnel, supervisors also can have a critical role in determining employer liability for employment-related claims. Recently, the U.S. Supreme Court and the Seventh Circuit have issued decisions that help employers define "supervisors" in the organizations who can create liability for harassment claims.

Supreme Court Defines "Supervisor" for Purposes of Harassment Liability Under Title VII

In a Title VII sexual harassment case, an important preliminary question is whether the individual accused of harassment is the employee's supervisor, in which case the employer is strictly liable for any harassing conduct that results in a negative employment action, or whether the accused is a non-supervisory co-worker, in which case the employer can avail itself of certain defenses such as implementation of an effective anti-harassment policy and complaint procedure. On June 24, 2013, the U.S. Supreme Court decided Vance v. Ball State University, No. 11-556, 570 U. S. __ (2013), which answers the important question of when an employee will be considered a "supervisor" for purposes of assessing Title VII liability for harassment.

Maetta Vance (Vance), who is African-American, worked for Ball State University (BSU) since 1989. Originally hired as a substitute server, she was promoted in 1991 to a part-time catering assistant position, and in 2007 became a full-time catering assistant. Vance worked with BSU employee, Saundra Davis (Davis), a Caucasian catering specialist. Vance complained of harassment and other allegedly unlawful conduct by Davis, including such things as intimidation and strange looks. The district court entered summary judgment in favor of BSU on Vance's lawsuit alleging racial harassment, among other things, in violation of Title VII. The court explained that BSU could not be held vicariously liable for Davis' alleged racial harassment because Davis was not Vance's supervisor under applicable court precedent. The court further held that BSU could not be liable in negligence because it responded reasonably to the incidents of which it had knowledge. The Seventh Circuit affirmed summary judgment for BSU. Vance appealed to the U.S. Supreme Court.

Under established Supreme Court precedent in *Burlington Industries, Inc.* v. *Ellerth*, 524 U. S. 742 (1998) and *Faragher* v. *Boca Raton*, 524 U. S. 775 (1998), an

employer is directly liable for an employee's unlawful harassment if the employee can show that the employer was negligent with respect to the offensive behavior. However, different rules apply when the harassing employee is the employee's supervisor. In that case, an employer may be vicariously liable, or strictly liable, for an employee's creation of a hostile work environment. Therefore, whether an alleged harasser is a "supervisor" or a co-worker is a critical question, about which courts around the country have disagreed.

Some courts adopted a narrower view of a "supervisor," and require an employee to have the power to implement such decisions as hiring, firing, demotions, promotions and transfers, to be considered a supervisor for purposes of Title VII liability. Other courts have taken a broader approach, and vest supervisory status in employees with authority "of sufficient magnitude so as to assist the harasser explicitly or implicitly in carrying out the harassment." This definition could include a broader group of individuals such as those who exercise direction over an employee's daily work assignments.

The Supreme Court rejected this broader approach, and held that for purposes of imposing vicarious liability on an employer for unlawful harassment, a supervisor must be empowered to take tangible employment actions against the employee, or, in other words, to effect a "significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits."

Here, Vance claimed that Davis at times gave instruction to Vance and other kitchen workers, and that Davis' job description vested her with certain leadership. Because Davis did not have the authority to hire, fire, demote, promote, transfer or discipline Vance – which was admitted to by Vance – Davis was not a supervisor capable of subjecting BSU to strict liability.

Seventh Circuit Sexual Harassment Decision Highlights Importance of Employee Training

Conversely, a month later, the Seventh Circuit U.S. Court of Appeals (covering employers in Illinois, Wisconsin and Indiana) decided that a supervisor need not have hiring or firing authority in order to create liability for failing to respond properly to a harassment complaint. *Lambert v. Peri Formworks Sys., Inc.,* Case No. 12-2502 (7th Cir., 7/24/13).

McKinley Lambert was a yard worker for Peri Formworks Systems, Inc. (PFS). Mr. Lambert complained to two yard leads several times between 2004 and 2007

about alleged ongoing sexual harassment. According to Mr. Lambert, a male co-worker repeatedly made sexual overtures toward him that included unwanted touching, requests for sexual acts, and exposing himself to Mr. Lambert. Mr. Lambert also complained to a logistics manager of race discrimination by that logistics manager and another employee, who both allegedly used offensive racial slurs to refer to Mr. Lambert and another African-American employee.

In 2007, Mr. Lambert was terminated for having a blood alcohol level of 0.01 at work, in violation of PFS's zero tolerance policy for alcohol use on the job. Mr. Lambert sued, alleging sexual and racial harassment, race discrimination, and retaliation. The federal district court granted summary judgment to PFS and dismissed the case.

On appeal, the Seventh Circuit reversed summary judgment for PFS on Mr. Lambert's claims of sexual harassment. The court rejected PFS' argument that the company was not put on notice of the harassment because the yard leads to whom Mr. Lambert complained did not have sufficient managerial authority to trigger notice to the company. Yard leads at PFS were responsible for instructing and organizing yard worker teams but could not hire, fire or discipline employees.

Instead, the Seventh Circuit held that although the yard leads were not "supervisors" who would trigger strict liability under Title VII if they had themselves engaged in sexual harassment, they could have sufficient authority to place PFS on notice of the alleged harassment based on Mr. Lambert's harassment complaints to them. The court observed that employer liability for alleged co-worker harassment may be triggered not just by notice to an individual with authority to take corrective action, but by notice to "someone who could reasonably be expected to refer the complaint up the ladder to the employee authorized to act on it." In this case, the testimony of one of the yard leads reflected that yard leads at PFS were expected to report "anything that was going wrong" to the yard manager, including complaints of sexual harassment. Such testimony would permit a trier of fact to conclude that a complaining employee could reasonably expect that a yard lead had the responsibility to, and would, refer harassment complaints to someone who could address the problem.

How Employers Can Minimize Risk

These decisions refocus attention on the importance of job descriptions, clearly delineated and adhered-to roles in the supervisory chain of command, and possibly most significantly, employee training on harassment and complaint-handling procedures. While supervisors with sufficient authority to make tangible

employment decisions will be able to subject an employer to strict liability for their own harassing conduct, individuals with far less authority may create liability for their company by failing to report or respond to a harassment or discrimination complaint from another employee. Following these decisions, well-drafted job descriptions, consistent decision making protocols and practices, and training will be powerful tools in the defense of harassment cases where supervisor status is called into question.

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