THE MONITOR

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Johnson Fistel Announces Affiliation with Esq. Wealth Management, Inc.

Johnson Fistel is a full-service law firm with experienced lawyers but does not offer financial advice to its clients. However, the law firm is pleased to announce that it is now affiliated with Esq. Wealth Management, Inc. ("EsqWealth"), a Registered Investment Advisor firm registered with the California securities regulators.

EsqWealth is a wealth management firm that, in conjunction with its affiliated professionals and alliances, is made up of experienced lawyers and financial professionals with advanced degrees, certifications, and first-hand life-experience in taxation, asset protection, and high-net-worth wealth management.

Knowing you have a trusted Registered Investment Advisor team in your corner makes a big difference in giving you peace of mind that you have the right financial plan. EsqWealth offers strategies for tax mitigation, financial planning, asset protection, and long-term wealth management. Johnson Fistel's managing partner, Frank J. Johnson, is the Founder and Chief Executive Officer of EsqWealth. Mr. Johnson is also a Certified Private Wealth Advisor® professional. The CPWA® certification is an advanced education and certification program for financial advisors who work with high-net-worth clients on the life-cycle of wealth: accumulation, preservation, and distribution.

EsqWealth can serve as your Legal, Asset, & Business Quarterback. For more information about EsqWealth, its unique approach to financial planning, and its team, please click here or go to https://www.esqwealth.com.

You are receiving this newsletter because we believe that the information provided will be of interest to you and any persons on whose behalf you make investment decisions. If you would like additional copies, or to opt out of our mailing list, please call 619.230.0063 or email us at ContactUs@JohnsonFistel.com.

In This Issue

Attorney Insights

Pg.	Topic
1	Johnson Fistel Announces Affiliation with Esq. Wealth Management, Inc.
2	Financial and Estate Planning New Year's Resolutions
4	Johnson Fistel, LLP Appointed Co-Lead Counsel in Nikola Corporation Derivative Case
4	Know Your Tolerance for Risk
6	Johnson Fistel Names New Partner: Kristen O'Connor
6	Johnson Fistel Welcomes New Attorney Anthony E. Mance
7	Johnson Fistel, LLP Secures Sweeping Reforms At CoreCivic
8	Google Settles Claims of Systemic Gender Discrimination for $118 Million
9	Delaware Provides Corporate Officers with Additional Liability Protection
11	They're Not Lovin' It: What McDonald's Tells Us About Officer Oversight
	News & Events
15	Upcoming Lead Plaintiff Deadlines
	Firm Information
14	Employment and Labor Litigation
16	Portfolio Monitor—Free Portfolio Monitoring
17	About the Firm and Contact Information

Financial and Estate Planning New Year's Resolutions

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Starting a new year is often a time for resolutions. Some studies show that one-third of Americans will make a financial resolution. Why not consider financial, estate, and related planning in formulating your commitments for 2023. Consider scheduling a review meeting regarding your estate, financial, retirement, and related planning. There may be planning considerations that are vital to protect your family and finances and to better achieve your goals. At EsqWealth, we highly recommend starting with a comprehensive financial plan that is regularly evaluated and updated. And the New Year is a good reminder to do so if you have not done so recently. Here are some points you might consider.

Core Estate Planning Documents

If your will, revocable trust, power of attorney, living will, health care proxy, and HIPAA release are more than three years old, or if you've experienced major life changes (e.g., divorce, marriage, new children, grandchildren, or significant health issues), review these documents. Are the individuals you've named in various roles still appropriate? Are there personal concerns not addressed in the documents? Has the reduction in the estate tax exemption by half in 2026 been reflected?

Adult Children

Once a child reaches age 18, a parent may not make medical or financial decisions on their behalf without being appointed agent. Yet most adult children don't have a durable power of attorney or health proxy (and if your adult child has any significant assets, a will). Resolve to help guide adult children to get critical documents, even simple ones, in place.

If you haven't communicated anything about your planning or documents to your adult children, start to consider what information is appropriate to communicate and when. Begin the process, even with small steps, as appropriate this year.

Update and Evaluate Your Balance Sheet

There are numerous benefits to preparing or updating a personal financial statement, or balance sheet, and providing a copy to your planning team (CPA, estate planning attorney, wealth advisor, etc.):

- Disability planning. If you become ill or incapacitated, the individual you appoint under a power of attorney or revocable trust as your agent or successor trustee will have to marshal assets, pay bills, and assist you. An organized list of assets will help them do so.
- Asset allocation considerations. Your investment advisor needs to know all the assets that you have so that they can properly evaluate and update (rebalance) your investment allocation. With the economy in turmoil and a recession forecasted by most experts, it's especially important.
- Asset protection. When protecting assets from unexpected lawsuits and third-party claims, which everyone should consider, you and your lawyer or financial advisor should evaluate each asset owned and consider how that particular asset might be protected. Analyze each asset as to significant risks it might entail (e.g., a rental property, investment accounts, and retirement accounts). Having a detailed, current, and accurate balance sheet is a starting point for this analysis.
- Property and liability insurance planning. Review your risks and assets to be sure you have adequate property and liability insurance coverage starting with a current balance sheet with some details as to what various assets are and how they're owned. Also recognize that umbrella policies have pages and pages of exclusions for which no coverage will be provided.

Review Certain Forms

Review your beneficiary designation forms, deeds, and other account titles. Many assets (e.g., retirement accounts, life insurance policies, and annuities) aren't transferred by will, but rather are based on a beneficiary designation form. Review

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the beneficiary designation forms for your various accounts to determine whether they're consistent with your estate plan. The SECURE Act 2.0 has, for some, dramatically changed the decision as to whom or what trust to name as beneficiary. If you haven't yet done a complete review of all of these forms, you should commit to do so in 2023.

If an asset is titled jointly, on death it passes to the surviving joint tenant. This result may not be the result you wish; that is, would you rather the interest in the home pass to a trust for the benefit of the survivor?

Bank accounts and other assets can be listed as "Pay on Death to" or "Transfer on Death to" and in similar ways so the ownership documents govern who inherits the accounts on your death, which may be inconsistent with your plan. For example, if your goal is to pass these assets into flexible and protective trusts, the wrong title may prevent that.

Review Insurance Planning

Financial forecasts may be essential to evaluating insurance needs. If you engaged in significant estate planning in recent years (e.g., because of the harsh estate tax proposals in 2020 to 2021), your insurance needs (or wants) may have been substantially affected. Explore (1) disability insurance to protect you by replacing some of your lost income if you're disabled; and (2) long-term care insurance to offset the costs of health care if disabled or as you age, to determine if your coverage is sufficient.

Have your entire insurance plan reviewed to determine if you have sufficient coverage to protect yourself and your loved ones. Life insurance policies should be periodically reviewed to determine if they're performing reasonably and are still consistent with your current and expected financial needs or wants. Don't assume that an insurance policy purchased years ago is still what you need or want. Insurance needs to be monitored periodically.

Administration of Trusts and Entities

If you have any irrevocable trusts (e.g., insurance trusts, spousal lifetime access trusts, or asset protection trusts) or business/investment entities (e.g., limited liability companies, family limited partnerships, and S corporations), review their governing legal documents, as well as other formalities of proper operation of trusts and entities to determine if you're taking all required and/or recommended actions. If you don't adhere to the formalities and respect the independent reality of each trust and entity, the courts, creditors, and Internal Revenue Service may not respect them either. This could potentially undermine your planning and goals.

Trust Income Tax Planning

Irrevocable complex (nongrantor) trusts' tax brackets are compressed, so they pay the maximum tax rate at a mere $14,000 or so of income. This amount is significantly lower than an individual's tax brackets (that is, a married couple might not reach the top income tax bracket until $600,000 or so income). You and your professional team should monitor the income tax profile of your trusts. Review the permissible beneficiaries for each trust, analyze their tax profiles, and analyze and determine how and when to make trust distributions to reduce the overall income tax burden of the family.

If you have any questions on points raised above or other aspects of your financial and estate planning, please visit it us at www.EsqWealth.com or contact us at FrankJ@EsqWealth.com.

The information above is not intended to and should not be construed as specific advice or recommendations for any individual. The opinions voiced are for general information only and are not intended to provide, and should not be relied on for tax, legal, or accounting advice. To discuss specific recommendations for any unique situation, please feel free to contact us.

Johnson Fistel, LLP Appointed Co-Lead Counsel in Nikola Corporation Derivative Case

On January 12, 2023, the Hon. Kathaleen St. Jude McCormick appointed Barbara Rhodes, Zachary BeHage, and Benjamin Rowe as Lead Plaintiffs in the Nikola consolidated stockholder derivative action. Chancellor McCormick also appointed Johnson Fistel, LLP and Cohen Milstein Sellers & Toll PLLC as Co-Lead Counsel to represent the plaintiffs' interests in the action.

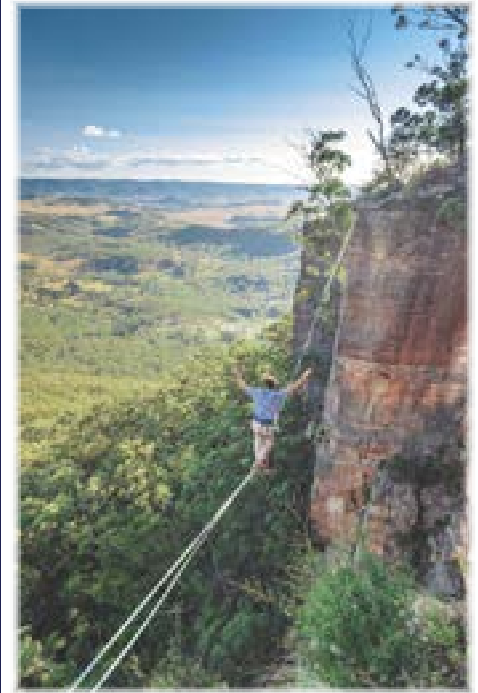
The plaintiffs' consolidated complaint filed on behalf of Nikola against certain current and former officers and directors of the company brings claims for failing to prevent the company's former Chief Executive Officer and director, Trevor Milton, from misrepresenting to investors that Nikola had built an impressive business model with its own proprietary turbine, battery, hydrogen fuel cell, hydrogen production technologies, and zero-emissions trucks. The consolidated complaint alleges that "[u]sing social media platforms, investor presentations, podcasts and Securities and Exchange Commission filings, Milton repeatedly overstated and misrepresented Nikola's business, technology and expected financial performance in a conscious effort to inflate the price of Nikola's stock." As a result of Milton's false statements, the Company achieved an artificial valuation as high as $28.77 billion.

Milton's actions caused significant harm to Nikola. In 2021, the company agreed to pay a civil penalty of $125 million to settle a fraud investigation by the Securities and Exchange Commission that was based on the same allegations put forth in the derivative and related securities class actions.

On October 14, 2022, a federal jury found Milton guilty of defrauding investors by lying about the supposed technical achievements of Nikola. Milton was convicted of one count of securities fraud and two counts of wire fraud and is now facing a prison sentence of up to 20 years.

In re Nikola Corporation Derivative Litigation, C.A. No. 2022-0023-KSJM (Del. Ch.).

Know Your Tolerance for Risk



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Multigenerational financial peace can be achieved through comprehensive planning. At EsqWealth, we help you strategically position and protect your assets so that you can rest assured that your vision of financial success is achievable. One important piece of your financial plan is your investment strategy. Constructing the right portfolio involves at least three important factors: your goals, your time horizon, and your tolerance for risk. Of those three, risk tolerance may be the most difficult on which to put a precise figure, especially since it can be swayed in large part by your emotions and how well you handle volatility or the unexpected rising and falling of the stock market. Below are a few considerations you should evaluate

What is risk tolerance?

To begin getting a handle on risk tolerance, it's important to understand that different investments have different risk and reward profiles. For

(Continued from Page 4)

example, stocks tend to be relatively risky investments; prices can fluctuate widely in the short term. In return for taking on this risk, stocks offer investors higher potential returns. Bonds, on the other hand, present much less risk. While it's possible that bond issuers could default, generally speaking, investors receive their investment back plus interest. Bonds' lower risk profile translates into lower potential returns for investors.

Risk tolerance refers to how much money an investor is willing to lose in the short term for a shot at greater potential gains over the long term. Everyone's risk tolerance is going to be different and will depend on several factors, including age, income, overall assets, long-term financial goals, and personality.

How to determine your risk tolerance

To figure out your risk tolerance, it can help to ask yourself questions such as:

- What are my investment goals?
- How much investment capital do I have to work with, and do I have other sources of income?
- What is my time horizon? When will I need to liquidate my investment?
- How much of my investment can I stand to lose if the market crashes?

With a clear idea of financial goals in mind, an investor is better positioned to determine what sort of investment assets are likely to help achieve those goals. For example, investors saving for retirement may want to take advantage of the growth potential offered by stocks.

Investors with a stable source of income at their disposal may be in a position to take on more risk with their investable assets.

Time horizon is closely tied to risk tolerance. For example, a younger investor saving for retirement may be willing to devote a higher portion of their portfolio to riskier investments, such as stocks, because they have more time to ride out market volatility and recoup potential losses down the road. Once that same investor begins approaching retirement age, they may find they need the return on their investment to be more predictable, and their risk tolerance will decrease. At that point, they may begin to shift their asset allocation to lower-risk investments, such as bonds and cash.

Finally, it's important to know yourself. What types of investment decisions will keep you up at night? If you're losing sleep over market volatility, for example, it might be a good sign that it's time to consult your financial advisor about building a more conservative portfolio. If you're someone with a hardier disposition who makes an investment and doesn't even look when markets get bumpy, you may be able to tolerate a riskier portfolio.

Developing your portfolio

Once you understand your risk tolerance, you can work with an advisor to allocate assets in your portfolio accordingly. With a high-risk tolerance, you might hold 90% of your portfolio in stocks with just 10% in more conservative investments, for example. With a low-risk tolerance, you might hold 50% of your portfolio in stocks.

A good and trusted financial advisor can help you use other tools, such as diversification, to help manage risk and volatility within your portfolio. Holding many types of assets across factors such as sector, size, and geography can help ensure that while some investments may be struggling at a given moment, others may outperform.

The information above is not intended to and should not be construed as specific advice or recommendations for any individual. The opinions voiced are for general information only and are not intended to provide, and should not be relied on for tax, legal, or accounting advice. To discuss specific recommendations for any unique situation, please feel free to contact us.

Sources

https://www.investor.gov/introduction-investing/getting-started/assessing-your-risk-tolerance

https://www.cnbc.com/select/how-to-figure-out-your-risk-tolerance-investing/

Johnson Fistel Names New Partner: Kristen O'Connor

The firm is pleased to announce that Kristen O'Connor has been elevated to partner effective January 1, 2023. Ms. O'Connor is based in the firm's San Diego, California office. "After just completing a two-week jury trial with her, I'm excited and honored to have Kristen as a partner and have her on our team," said Frank J. Johnson, the firm's managing partner. "She is aggressive, smart, and a prodigious trial lawyer."

Ms. O'Connor has spent her litigation career representing individuals in shareholder and complex litigation, as well as a diverse clientele in federal and state employment civil rights actions for harassment and discrimination. She is an experienced first-chair trial attorney and is deeply committed to serving as a principled and aggressive advocate for workers' rights. Ms. O'Connor has handled high-stakes civil matters at all stages, from prelitigation investigations and discovery through trial.

Ms. O'Connor is a fourth-generation California trial attorney: Great-Grandfather, William L. Bradshaw, Judge, Kern County Superior Court; Grandfather, Richard W. Bradshaw, formerly Asst. District Attorney and Judge pro tem, Kern County; Uncle, the Honorable J. Eric Bradshaw, Asst. Presiding Judge, Kern County Superior Court.

Ms. O'Connor has been named by Thomson Reuters' Super Lawyers as a leading San Diego, California lawyer since 2020. She was also selected by the organization as a 2020, 2021, and 2022 Rising Star, a designation awarded to no more than 2.5% of attorneys in each state.

Ms. O'Connor holds an LL.M. degree in Securities and Financial Regulation from Georgetown University Law Center. She received her Juris Doctor degree from the Thomas Jefferson School of Law, where she graduated summa cum laude and third in her class. As the highest scoring student in her law school class, she received the CALI Award for Excellence in Legal Writing I, Legal Writing II, Civil Practice, Contracts I, Property II, Entertainment Law Transactions, and Wills and Trusts. She also received the Jefferson Medal for Mediation and Negotiation. During law school, she had the distinct honor of serving as both a faculty teaching and research assistant. She also served as an editor for the Thomas Jefferson Law Review, where her work in intellectual property was published.

Ms. O'Connor received a Bachelor of Arts degree from California Lutheran University, where she received academic scholarships. During her senior year, she studied Eastern European history and the Czech language as a visiting student at Charles University in Prague, Czech Republic.

Johnson Fistel Welcomes New Attorney Anthony E. Mance

Johnson Fistel is pleased to announce the addition of Attorney Anthony E. Mance to its Atlanta office. Mr. Mance will focus his practice on complex commercial litigation with an emphasis on securities class actions and shareholder derivative actions.

Mr. Mance has been an attorney for 14 years. He has over a decade of experience working on complex discovery and trial preparation matters on multiple high-profile shareholder derivative and securities class action cases.

Mr. Mance is a graduate of the California Western School of Law. While attending California Western, Mr. Mance was repeatedly named to the Dean's List and received two American Jurisprudence Awards in Professional Responsibility and Wrongful Conviction Seminar. He also served as a law and philosophy research assistant, was a member of the International Law Society, and completed professional training in cross-cultural alternative dispute resolution.

Prior to completing his legal studies, Mr. Mance attended Purdue University where he earned a Bachelor of Arts degree in Political

(Continued on Page 7)

(Continued from Page 6)

Science with dual minors in English and History.

"I am truly honored to be a part of the Johnson Fistel team. I look forward to vigorously and creatively helping our clients achieve their objectives and protect their rights. "We are delighted to add Anthony to our already talented crew in Georgia, and we look forwarding to leveraging Anthony's experience in complex shareholder litigation to serve the best interests of the firm's clients nationwide," added Michael Fistel, Jr., the firm's co-founding partner.

Johnson Fistel, LLP Secures Sweeping Reforms At CoreCivic

On December 2, 2022, The Hon. Aleta A. Trauger granted final approval of a shareholder derivative settlement which resolved consolidated shareholder lawsuits pending in the United States District Court for the Middle District of Tennessee, as well as a related shareholder lawsuits pending in Tennessee and Maryland state courts, and a related shareholder litigation demand.

Johnson Fistel, along with co-lead counsel, negotiated the settlement which provides that CoreCivic will adopt for a period of at least four (4) years a series of corporate governance reforms relating to the Company's staffing policies and procedures, inmate safety and security policies and procedures, and healthcare services policies and procedures; improves risk and compliance controls and oversight; improves disclosure procedures and controls designed to ensure Board- and appropriate management-level oversight and the issuance of timely and accurate SEC filings, press releases, and other public disclosures; enhances Board independence requirements to ensure effective and disinterested decision-making and oversight by the Board; improves the Company's Whistleblower and Recoupment Policies; and overall increases transparency concerning the Company's corporate governance, policies, practices, and procedures. These Reforms will (i) substantially reduce the likelihood that the alleged failures will recur as the Reforms regime agreed-upon here effectively address the alleged lapses in internal controls and oversight that led to the Company's alleged losses, which will help to avoid a recurrence of the alleged wrongdoing in the future by (ii) improving the Company's practices at its prison facilities and ensure more rigorous, independent, and effective oversight, which will improve the Company's operations and Board- and management-level decision-making and therefore (iii) the Reforms confer significant economic value upon the Company.

In approving the settlement, Judge Trauger stated that she was "impressed with the overall settlement terms" and that she knew the negotiations were "hard fought" following six years of litigation.

The actions, brought on behalf of nominal defendant CoreCivic and against certain current and former directors and officers of the company, broadly allege that the Individual Defendants breached their fiduciary

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(Continued from Page 7)

duties to CoreCivic, were unjustly enriched, and that certain of the Individual Defendants sold their personally held shares of CoreCivic stock at artificially inflated prices while in possession of material non-public information.

More specifically, the actions allege that since early 2012, the Individual Defendants made and caused the Company to make false and misleading statements concerning the safety and security standards of CoreCivic facilities and the effectiveness of the Company's rehabilitative services, and the possibilities that the U.S. Department of Justice ("DOJ") would not renew or extend its contracts with the Company. As a result of the foregoing, the actions allege that the Individual Defendants caused the Company to make materially false and misleading public statements at all relevant times. As detailed in the operative complaint, former Deputy Attorney General Sally Yates revealed the truth about the Company's business practices on August 18, 2016, when she announced the DOJ's decision to end its use of private prisons, including those operated by CoreCivic. The actions contend that the Individual Defendants breached their fiduciary duties to CoreCivic by making or causing CoreCivic to make false or misleading statements to the public about CoreCivic's business, financial prospects, and operational and compliance practices in three general areas: (i) The safety and security standards of CoreCivic facilities compared to those of Federal Bureau of Prisons ("BOP") facilities; (ii) The effectiveness of CoreCivic's rehabilitative services compared to those provided by BOP; and (iii) The possibility that the Department of Justice ("DOJ") would not renew or extend its contracts with CoreCivic. As a result of the Individual Defendants' alleged misconduct, the Company's common stock traded at artificially inflated levels. The actions allege that while the stock price was inflated, and while in possession of material, adverse, and non-public information, certain of the Individual Defendants unloaded their holdings of CoreCivic stock at inflated prices, selling more than $33.4 million of personally held common stock. The actions further contend that the Individual Defendants' alleged misconduct exposed CoreCivic to liability in a securities fraud class action.

Attorneys Frank J. Johnson, Michael I. Fistel, Jr., and Oliver S. tum Suden led the prosecution of the litigation for Johnson Fistel and helped achieve this superb result on behalf of plaintiffs and CoreCivic.

In Re CoreCivic, Inc. Shareholder Derivative Litigation, Lead Case No.: 3:16-CV-03040 (M.D. Tn.).

Google Settles Claims of Systemic Gender Discrimination for $118 Million

On October 25, 2022, California Superior Court Judge Andrew Y.S. Cheng granted final approval of a $118 million class action settlement brought on behalf of 15,500 female Google workers. The women—many of whom worked as software engineers for the tech giant—alleged the company enabled a sweeping culture of unchecked gender bias, including effecting company-wide pay and promotion discrimination against its female employees.

The case challenged two alleged systemic practices at Google: 1) that the company pays its female employees less than their male counterparts, in violation of California's Equal Pay Act, California Labor Code §1197.5 and California's Unfair Competition Law, California Business and Professions Code §17200, and 2) that the company assigns its female employees to lower job levels than their male counterparts, in violation of California's Fair Employment and Housing Act, California Government Code §12900 et seq. The parties reached preliminary settlement in June 2022, which contemplated a $118 million payout along with substantial programmatic relief. That pro-

(Continued from Page 8)

grammatic relief includes the company's engagement of third-party experts who will evaluate the company's pay equity process and level-settling processes, among other remediation. Those terms were fully and finally approved by Judge Cheng in October 2022.

If you believe you have been illegally victimized by your employer or another person in the workplace, please contact us for a free consultation and case evaluation. You may telephone us at (619) 230-0063 or e-mail us at contactus@johnsonfistel.com.

Delaware Provides Corporate Officers with Additional Liability Protection

As leaders entrusted with the success of a corporation, both directors and officers owe fiduciary duties to the company and its shareholders. These fiduciary duties include the duty of care and the duty of loyalty. In a nutshell, the former requires directors and officers to make informed decisions and the latter requires them to put their own interests behind those of the corporation and its shareholders and refrain from acting in bad faith.

Since 1986, Delaware law has allowed corporations registered in that state to exculpate their directors from incurring personal monetary liability to the company or its shareholders for breaches of the duty of care, as long as the corporation expressly sets forth this protection in its certificate of incorporation. Until recently, these provisions did not apply to corporate officers.

On August 1, 2022, Delaware amended Section 102(b)(7) of its General Corporation Law to permit Delaware corporations to exculpate their officers from liability arising from breaches of their fiduciary duties. However, unlike directors, such exculpation of officer liability only applies to direct claims, meaning that any action brought in the right of the corporation, such as a derivative action, are excluded from exculpation. Interestingly, the Delaware legislature did not provide any rationale explaining why it deemed such an amendment necessary, nor did it provide any justification for its authority to do so. However, the Delaware legislature clearly recognized the importance of allowing the corporation itself to recover from officers who violate their fiduciary duties.

Officer exculpation in Delaware does not necessarily equate to immunity from personal liability. For example, exculpation of officers for Delaware corporations is not automatic—the corporation must explicitly provide an exculpation provision in its certificate of incorporation for its officers to enjoy this protection. Therefore, officers are only exculpated if the company filed or amended its articles of incorporation after August 2022. Moreover, corporate officers are not exculpated from breach of fiduciary duty claims arising from conduct that occurred prior to the implementation of any such provision.

Not all corporate officers can be exculpated under the newly amended Delaware law. The officer positions eligible for exculpation from liability include the chief executive officer, chief financial officer, chief operating officer, chief legal officer,

(Continued on Page 10)

(Continued from Page 9)

chief accounting officer or treasurer, the company's most highly compensated executives as identified in SEC filings, and those who have consented to being identified as officers and to service of process.

Delaware is not the only state to permit the exculpation of corporate officers, nor is its new provision the strictest. For example, in 1987, Nevada implemented a statute allowing for corporations to include provisions in their articles of incorporation "eliminating or limiting the personal liability of a director or officer to the corporation or its stockholders for damages for breach of fiduciary duty as a director or officer, but such a provision must not eliminate or limit the liability of a director or officer for: (a) Acts or omissions which involve intentional misconduct, fraud or a knowing violation of law; or (b) The payment of dividends in violation of NRS 78.300."[1] Since 1987, Nevada has further amended this exculpation provision to be automatic, not limited to certain officers, and not exclude derivative actions. Comparatively, California does not presently permit the articles of incorporation to include a provision exculpating officers.

While many on the defense side may rejoice at these new changes, the overall significance of Delaware's amendment remains to be seen. Adoption of officer exculpation provisions in corporate charters does not appear to be a sure thing. For example, in its 2023 Policy Guidelines, the leading proxy advisory services company, Glass Lewis, generally recommended "voting against such proposals eliminating monetary liability for breaches of the duty of care for certain corporate officers, unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable."[2] Moreover, at least two separate complaints have been filed by two separate companies in Delaware Chancery Court challenging the adoption of certificate of incorporation amendments that implement officer exculpation.[3] Both lawsuits concern whether a non-voting share class is entitled to vote on the amendments and both complaints seek to invalidate the amendment. Although these cases do not challenge the law itself but rather, the procedure through which the corporations adopted the changes to their charters, it will be interesting to see how the Delaware Chancery Court addresses and resolves these novel issues regarding new officer exculpation provisions.

For now, voting-class shareholders should consider whether they want to permit corporate officers of Delaware corporations from escaping monetary liability for breaching their fiduciary duties. For more information or questions, please contact the Johnson Fistel, LLP team.

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1 1987 Nev. Stat. ch. 28, § 2.

2 GLASS LEWIS, 2023 POLICY GUIDELINES, at 10, https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf?hsCtaTracking=45ff0e63-7af7-4e28-ba3c-7985d01e390a%7C-74c0265a-20b3-478c-846b-69784730ccbd (last visited January 17, 2023).

3 *Electrical Workers Pension Fund, Local 103, I.B.E. W v. Fox Corporation*, C.A. No. 2022-1007-JTL (Del. Ch.); Sbroglio v. Snap Inc., C.A. No. 2022-1032-JTL (Del. Ch.)

(Continued on Page 11)

(Continued from Page 10)

They're Not Lovin' It: What *McDonald's* Tells Us About Officer Oversight

On January 25, 2023, the Delaware Court of Chancery rendered an important decision that clarifies that corporate officers owe a duty of oversight equal to, if not greater than directors' duty of oversight. As with the directors' duty of oversight, establishing a breach of the officer's duty of oversight requires pleading and later proving disloyal conduct that takes the form of bad faith. This duty includes addressing red flags and reporting them upward. The decision in *In re McDonald's Corporation Stockholder Derivative Litigation,* No. 2021-0324-JTL (Del. Ch. Jan. 25, 2023) has far reaching consequences in determining corporate officer liability in derivative litigation.

McDonald's employs over 200,000 people, mostly young people in entry-level positions and the Company boasts that its "America's best first job." While over half of McDonald's employees are women, at more senior levels, the percentage of women drops dramatically. Beginning around 2015, McDonald's Chicago headquarters allegedly began to take on a "party atmosphere" where the eighth floor of the office had open bar happy hours and employees frequently drank alcohol at other company affiliated events.

Chief Executive Officer ("CEO") Stephen J. Easterbrook ("Easterbrook"), together with Executive Vice President and Global Chief People Officer David Fairhurst ("Fairhurst") developed reputations for flirting with female employees, including their executive assistants. Recruiters were encouraged to hire "young, pretty females" from high-end stores to work in administrative roles at the Chicago headquarters and the CEO became known as a "player" who pursued intimate relationships with staff. The human resource function overseen by Fairhurst allegedly ignored complaints about the conduct of co-workers and executives and two former executives reported that employees felt as if they had little recourse for reporting bad behavior.

By October 2016, employees began to file complaints with the Equal Employment Opportunity Commission ("EEOC") that contained disturbing allegations about sexual harassment and retaliation. Following the uptick in EEOC complaints, McDonald's employees in over 30 cities across the U.S. organized a walkout, which was covered by major media outlets. By September 2018, EEOC complaints were identifying broad systemic issues throughout the Company in addition to individual instances of sexual harassment. Failure by management to address these problems led to a one-day, ten city strike in protest and attracted the attention of federal lawmakers.

Despite the Company's ostensible zero-tolerance policy for acts of sexual harassment and the Company's Board of Directors (the "Board") receiving reports that Fairhurst was sexually harassing employees, nothing changed. It was not until October 2019 that the Board terminated Easterbrook, purportedly upon learning that Easterbrook was engaging in a prohibited relationship with an employee. Notably, the Board elected to terminate Easterbrook "without cause," enabling Easterbrook to depart the Company with a massive severance package worth tens of millions of dollars.

Soon thereafter, the Board terminated Fairhurst based on his documented history of sexually harassing the Company's employees.

Less than two weeks after Easterbrook left McDonald's and the Board terminated Fairhurst,

(Continued on Page 12)

(Continued from Page 11)

Company employees filed a class action lawsuit challenging the Company's systemic problems with sexual harassment, alleging that McDonald's had a toxic culture where sexual harassment was pervasive throughout its restaurants and that two thirds of restaurant employees worked at locations that did not provide any sexual harassment training. McDonald's workers also alleged that employees lacked access to any human resources support and that the company's human resource department under Fairhurst refused to help workers at franchise restaurants. Another class action was filed shortly thereafter, this time on behalf of company owned restaurants, alleging that "three out of every four female non-managerial McDonald's employees have personally experienced sexual harassment at McDonald's, ranging from unwelcome sexual comments to unwanted touching, groping, or fondling, to rape and assault" and that employees were discouraged from lodging complaints.

After the public allegations about sexual harassment and misconduct at the company, a group of plaintiffs filed a stockholder derivative action alleging that Fairhurst engaged in inappropriate conduct with female employees and exercised inadequate oversight in response to risks of sexual harassment and misconduct at the company and its franchises.

In denying Fairhurst's motion to dismiss, the court, for the first time, expressly held that corporate officers also owe a duty of oversight. While neither the Delaware Supreme Court nor the Delaware Court of Chancery said explicitly that corporate officers owe oversight duties, they have equated officer duties with director duties.

The court follows the same rationale for directors' duty of oversight and applies it to officers. "In the typical corporation, it is the officers who are charged with, and responsible for, running the business of the corporation."[1] "In fact, without officers, there would be no one to make important day-to-day operational decisions or to supervise the lower-level employees who keep a firm running."[2] Because of this governance, "[m] onitoring and strategy are not exclusively the dominion of the board. Actually, nondirector officers may have a greater capacity to make oversight and strategic decisions on a day-to-day basis."[3] From this perspective, the Caremark oversight role "is more suited to corporate officers who are responsible for managing the day-to-day affairs of the corporate enterprise."[4]

Resultantly, the officers who serve as the day-to-day managers of the business must make a good faith effort to ensure that information systems are in place so that they receive relevant and timely information that they can provide to the directors. *Think Strategically*, *supra*, at 488. The reality that officers require information to function in their roles provides further support for officers having oversight obligations. The court proposed the following hypothetical:

Pause for a moment and envision an officer telling a board that the officer did not have any obligation to gather information and provide timely reports to the board. The directors would quickly disabuse the officer of that notion, and an officer who

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1 Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. Davis L. Rev. 271, 285 (2014)..

2 Nadelle Grossman, *The Duty to Think Strategically*, 73 La. L. Rev. 449, 488 (2013) ("*Think Strategically*").

3 Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. Ill. L. Rev. 1131, 1160–61 (2013).

4 Dominick T. Gattuso & Vernon R. Proctor, *Reining in Directors and Officers in Corporate America in Delaware, the Answer Is Not to Expand Their Personal Liability*, Bus. L. Today, January/February 2010, at 46, 49..

(Continued on Page 13)

(Continued from Page 12)

did not get with the program would not hold that position for long.

Another critical part of an officer's job is to identify red flags, report upward, and address them if they fall within the officer's area of responsibility. Once again, pause and envision an officer telling the board that their job did not include any obligation to report on red flags or to address them. A similar learning opportunity would result.

In the unrealistic hypothetical where an officer declares those contrarian beliefs upfront, the directors are in a position to disabuse the officer of his misconceptions or terminate the officer's role. But directors may only learn about an officer's failure to establish information systems or to identify and report red flags after a corporate trauma has occurred. It is unfathomable that a board would sign off on an officer's expressed intent to put his head in the sand, not make any effort to gather information or report to the board, and not make any effort to address red flags. It is similarly unfathomable that a board could not take action if an officer failed to fulfill those obligations. Yes, a board might determine that disciplining or terminating the officer was sufficient and that a lawsuit was not necessary. But in a case where the officer's failure to exercise oversight had caused the corporation harm, a board could decide to assert a claim for breach of fiduciary duty against an officer. The board should be able to do so.

The *McDonald's* plaintiffs successfully alleged officer oversight claims allowed a culture of sexual misconduct and sexual harassment to develop at the Company. Specifically, they alleged that Fairhurst knew about evidence of sexual misconduct and acted in bad faith by consciously disregarding his duty to address the wrongdoing. The *McDonald's* plaintiffs pointed to several major red flags that for someone in Fairhurst's position, should have been figuring out whether something was seriously wrong and either addressing it or reporting upward to the CEO and the directors.

Despite numerous red flags, Fairhurst allegedly engaged in serial sexual harassment himself, had the human resource department ignore complaints about the conduct of his co-workers and other executives, and the Company's Section 220 production had no evidence that McDonald's was taking meaningful action to address problems with sexual harassment and misconduct until early 2019.

The court was clear that Fairhurst's alleged conduct, if proven, would be a breach of fiduciary duty of oversight and loyalty case and not a sexual harassment case. "Like an oversight claim, a claim for breach of duty based on the officer's own acts of sexual harassment is derivative, so all of the protections associated with derivative claims apply" and is not duplicative of other remedies. In sum, "[s]exual harassment is bad faith conduct. Bad faith conduct is disloyal conduct. Disloyal conduct is actionable." As a result of this decision, Delaware expressly applied directly fiduciary duties of oversight to the officer in the derivative litigation context and found that the *McDonald's* plaintiffs successfully pleaded breach of the duty of oversight and breach of the duty of loyalty. This holding means that oversight liability in the derivative context can extend beyond directors to company officers in certain situations.

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Company	Deadline
Sunlight Financial Holdings Inc. f/k/a Spartan Acquisition	2023-02-14
Daktronics, Inc.	2023-02-20
Gaia, Inc.	2023-02-21
Tattooed Chef, Inc.	2023-02-21
Gaotu Techedu Inc. f/k/a GSX Techedu Inc.	2023-02-28
Avaya Holdings Corp.	2023-03-06
Enovix Corp.	2023-03-06
ESS Tech Inc.	2023-02-14
Southwest Airlines Co.	2023-03-13
Y-mAbs Therapeutics, Inc.	2023-03-20
Argo Blockchain plc	2023-03-27
Allianz SE	2023-04-03
Block, Inc.	2023-04-03
Ryvyl Inc.	2023-04-03
Atlassian Corporation	2023-04-04
PLDT Inc.	2023-04-07
Global Payments, Inc.	2023-04-07

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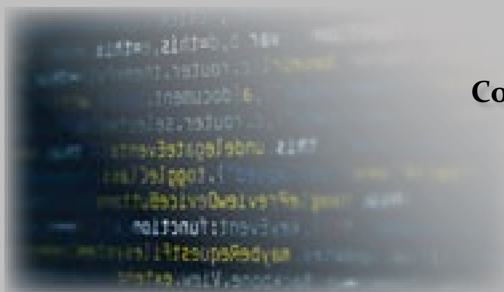

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JF Johnson Fistel

Partners

Frank J. Johnson | Michael I. Fistel, Jr. | Brett M. Middleton | Mary Ellen Conner | Kristen L. O'Connor

Associates & Counsel

Support Team

Jim Baker | Tyler Baker | Ashley Lane | Serena Lee | Luz Lopez | Bridget Morrell | Jennifer Sanders | Savannah Vasquez

Contact Us

San Diego Office

501 West Broadway, Suite 800
San Diego, California 92101
T: 619.230.0063
F: 619.255.1856

Georgia Office

40 Powder Springs Street
Marietta, Georgia 30064
T: 470.632.6000
F: 770.200.3101

New York Office

620 Fifth Avenue, 2nd Floor
New York, New York 10020
T: 212.292.5690
F: 212.292.5680

Contact Us:
ContactUs@JohnsonFistel.com

Visit Us:
http://www.JohnsonFistel.com