New England IN-HOUSE

November 2018 | Vol. 16, No. 4

SEC embracing analytics as tool to catch crooked traders

EVERYTHINGPOSS

Lawyers, cos. grapple with regulatory risks

By Pat Murphy

An indictment unsealed in federal court in Boston serves as a stark warning to lawyers and their clients of the increasing regulatory risk posed by the Securities and Exchange Commission's use of advanced analytics to detect illicit trading activity.

On Sept. 12, the U.S. Attorney's Office announced that Michael Bressman had been arrested and charged with securities and investment advisor fraud. The government alleged that the New Jersey broker had engaged in a "cherry-picking" scheme to obtain $700,000 in illicit trading profits over a six-year period.

The SEC filed fraud charges against Bressman in a parallel action in New York federal court. In announcing the enforcement action, the SEC highlighted that the alleged fraud had been uncovered through

Continued on page 14

Foreign company's sales subject it to jurisdiction

'Sizeable, continuing commerce' is enough

By Kris Olson

In what it noted was a "close call," the 1st U.S. Circuit Court of Appeals ruled that it did not offend the Due Process Clause of the Constitution to exercise specific personal jurisdiction against a German corporation that derived income from customers in the United States.

LYNCH
Decision a 'close call'

In the absence of clear guidance from U.S. Supreme Court, the 1st Circuit said it was deliberately avoiding creating any broad rules. To the extent the Supreme Court had spoken to the issue of whether online activities can translate into contacts for the purposes of the minimum contacts analysis, it had done so in far different factual scenarios, the 1st Circuit said.

Writing for the court, Judge Sandra L. Lynch noted the "baseline principle" that had emerged: that a website operator "does not necessarily purposefully avail itself of the benefits and protections of every state in which its website is accessible."

But the District Court judge below had observed that the defendant had gone further than making its website available, engaging in "sizeable and continuing commerce with United States customers."

If it did not want U.S. customers, the defendant had options, like designing its site to not interact with American users or posting a disclaimer that its service was not intended for U.S. users, the 1st Circuit noted. This defendant, however, had accepted payment from and voluntarily served U.S. customers for three and a half years.

The court also rejected the defendant's argument that it could not reasonably anticipate specific jurisdiction because it did not specifically

Continued on page 16

IN-HOUSE WITH ...

BRIAN R. ELWORTHY • TOAST

Brian R. Elworthy didn't need to do a whole lot of soul-searching to know the partner track wasn't for him. So after six years as an associate at Ropes & Gray, the Boston lawyer set out to find the right fit in an in-house role, starting first at inVentiv Health in Burlington, Massachusetts.

But it was a stint waiting tables back when he was in college that would help point the way for Elworthy, now general counsel at Toast, the maker of cloud-based restaurant management and point-of-sale software he calls "the heart and soul" of the modern restaurant.

The company's platform provides restauranteurs — from sole proprietors of pizza shops to large chains such as Jamba Juice — the tools to process orders and payments, track inventory, manage personnel, offer loyalty programs, and more.

Founded in 2012 in Cambridge, Toast has grown rapidly since Elworthy's arrival in 2016, topping 1,000 employees worldwide this year and extending its reach to all 50 U.S. states.

In June, the company closed a Series D funding round in which it was valued at $1.4 billion.

The swift expansion has meant a full plate for Elworthy and his department, which he's built from a solo operation upon his arrival into a five-member unit that he expects will grow this year and next.

On any given day, his responsibilities can run the gamut from helping the finance department prepare for a new investment round to reviewing Toast's compliance with upcoming regulations to documenting a partnership agreement with one of its outside partners such as GrubHub and TripAdvisor.

Elworthy recently sat down with New England In-House's Matthew Cove.

***

Q. *Professionally speaking, what keeps you awake at night?*

A. With things moving so quickly, making sure that we are thinking through everything properly from a legal

Continued on page 15

With proposed rule, NLRB set to revamp 'joint employer' test

By Pat Murphy

A divided National Labor Relations Board has proposed a new rule that raises the bar for establishing joint-employer status, effectively reversing one of the board's more controversial decisions issued when it was controlled by appointees of President Obama.

Under the proposed rule published for comment in September, a business can be found to be a joint employer of another company's employees only if it possesses and exercises substantial, direct and immediate control over the essential terms and conditions of employment.

Indirect influence and contractual reservations of authority would no longer be sufficient to establish a joint-employer relationship.

Management-side attorneys view the proposed rule as a return to the consistency and predictability of a joint-employer test in place for decades prior to the NLRB's 2015 decision in *Browning-Ferris Industries of California, Inc.*

Corey F. Higgins, a management-side lawyer in Worcester, Massachusetts, said he expected the NLRB to adopt a final rule along the lines of the proposed rule.

"The proposed rule can certainly give some clarity to the business community and address some of the concerns that businesses have about being made subject to the joint-employer standard, even when they don't have direct and immediate control over the terms and conditions of employment of another entity's employees," Higgins said.

But union-side attorneys see the rule as seriously undermining collective bargaining rights in a modern economy in which labor is frequently provided through contractor/subcontractor and franchisor/franchisee business relationships.

"What it does is insulate employers who have de facto control over a subcontractor or a franchisee by setting an almost insurmountable legal standard to establish joint-employer status," said Marc B. Gursky of North Kingstown, Rhode Island.

New rule

A finding of joint-employer status has significant consequences for businesses. For example, each joint employer can be found jointly and severally liable for unfair labor practices committed by the other.

Moreover, a joint employer may be compelled to bargain in good faith with the bargaining representative of the jointly-employed workers. That is an obligation that should not be underestimated considering that contract terms and franchise agreements can limit the ability of subcontractors and franchisees to meet worker demands.

"Collective bargaining is only truly effective when you can force to the table the company that has the ability to make the changes in the workplace that the employees are demanding," said Boston's James A.W. Shaw, who represents unions and employees.

The rule proposed by the board essentially codifies the joint-employer test as formulated in board decisions dating from the early 1980s. The rule states that an employer as defined under the National Labor Relations Act "may be considered a joint employer of a separate employer's employees only if the two employers share or codetermine the employees' essential terms and conditions of employment, such as hiring, firing, discipline, supervision, and direction."

The rule further states that a putative joint employer "must possess and actually exercise substantial direct and immediate control" over the essential terms and conditions of employment in a manner that is "not limited and routine."

Publication of the proposed rule in the Federal Register on Sept. 14 commenced a 60-day public comment period.

'Browning-Ferris' revisited

Board members Marvin E. Kaplan and William J. Emanuel joined board Chairman John F. Ring in proposing the new rule. All three are appointees of President Trump. The board's lone Democratic holdover, Lauren McFerran, wrote a dissent to the proposal.

McFerran criticized the majority for taking the unusual step of attempting to change the joint-employer test through its rulemaking authority when the NLRB typically speaks through its case decisions.

"The majority's decision to pursue rulemaking ensures the Board's standard will remain in flux as the Board develops a final rule and as that rule, in all likelihood, is challenged in the federal courts," McFerran wrote.

Nominated by President Obama in 2014, McFerran further pointed out that, unlike the NLRB's decisions, any final rule would not be given retroactive effect. That would mean that cases arising before the issuance of the final rule would be decided under the *Browning-Ferris* standard, she wrote.

In August 2015, a divided board in *Browning-Ferris* significantly relaxed the joint-employer standard. In that case, the majority decided to no longer require proof that a putative joint employer exercised any "direct and immediate" control over the essential working conditions of another company's workers.

Instead, a company can be deemed a joint employer even if its control over essential working conditions was indirect, limited and routine, or contractually reserved but never exercised. Higgins explained that, under *Browning-Ferris*, a reservation of rights over the terms and conditions of employment, though not exercised, can be evidence of a common-law agency relationship sufficient to support a joint-employer determination.

"The universe of potential employers who could be deemed to be a joint employer under the National Labor Relations Act is much broader than under *Browning-Ferris*," Higgins said.

Employers are right to be concerned that *Browning-Ferris* "upended" 30 years of precedent, according to Damien M. DiGiovanni, a management-side labor lawyer in Boston.

DiGiovanni's clients include colleges and universities, which frequently contract out to third parties certain functions such as food services. He said *Browning-Ferris* had many of those clients worrying about their exposure as potential joint employers of their contractors' employees.

"The concern for employers is that they're potentially liable for unfair labor practices for something they had nothing to do with," he said.

But *Browning-Ferris* deserves to stand, Shaw said.

"It was a very important decision, particularly in industries where there's a lot of subcontracting and contracting relationships," Shaw said. "The way labor law had worked prior to *Browning-Ferris* really limited some unions' ability to fully bargain about employees' complete working conditions."

The Republican-controlled NLRB did attempt to overturn *Browning-Ferris* in a 2017 decision, *Hy-Brand Industrial Contractors, Ltd.*

But that attempt to reverse *Browning-Ferris* failed when the board earlier this year voted to vacate the *Hy-Brand* decision. The board's action was in response to an ethics investigation that concluded Emanuel should have disqualified himself from participating in the case due to an apparent conflict.

By hook or by crook

Shaw said he feared that a rule overturning *Browning-Ferris* would allow a company to "contract itself out" of obligations it would otherwise have under the National Labor Relations Act.

"If the rule does go through, which is expected, it goes back to that situation where clever corporate contracting becomes a vehicle to 'lawfully' evade federal law," he said.

Shaw noted that it was highly unusual for the NLRB to resort to rulemaking to change its joint-employer standard.

Continued on page 15

"The proposed rule can certainly give some clarity to the business community and address some of the concerns that businesses have about being made subject to the joint-employer standard."

— Corey F. Higgins, management-side lawyer

Defamation suit against California company fails

No jurisdiction under Mass. long-arm statute

By Eric T. Berkman

An out-of-state tech firm that allegedly made disparaging statements about a Massachusetts competitor to companies with locations in Massachusetts was not subject to jurisdiction under the state's long-arm statute, G.L.c. 223A, §3, a trial court judge has decided.

Plaintiff SCVNGR, a Massachusetts-based maker of software applications for restaurant chains, claimed that defendant Punchh, a California-based competitor, repeatedly made knowingly false statements about its clients and potential clients.

The plaintiff, which conducted its business under the name LevelUp, alleged that those statements, though not made in Massachusetts or directly to Massachusetts companies, nonetheless caused it harm in the state. LevelUp also asserted that Punchh marketed its apps to companies with Massachusetts locations from which it derived revenue.

Accordingly, LevelUp argued, Punchh had sufficient contacts with Massachusetts for long-arm jurisdiction to apply.

But Judge Mitchell H. Kaplan, sitting in the Business Litigation Session, disagreed.

"The fact that some of Punchh's customers operated restaurants in Massachusetts and therefore used Punchh's apps in Massachusetts, does not translate into Punchh transacting business in Massachusetts," Kaplan said, dismissing the suit. "It also does not mean that when Punchh allegedly disparaged LevelUp to customers or potential customers outside of Massachusetts that constitutes a tort arising out of Punchh's having transacted business in the Commonwealth."

The 10-page decision is *SCVNGR, Inc. v. Punchh, Inc.*

New reality

Plaintiff's counsel, Joshua A. Lewin of Boston, declined to comment, as did Jeffrey J. Pyle of Boston, who represented the defendant.

But Boston business litigator Eric P. Magnuson said the case reflects the reality that the state's trial courts now must first address whether the exercise of jurisdiction over a defendant comports with the Massachusetts long-arm statute before addressing whether constitutional due-process standards are satisfied.

Magnuson was referring to the fact that Kaplan had initially ruled that due-process concerns were not satisfied and then, when LevelUp appealed, the Supreme Judicial Court found that the trial judge first had to engage in a long-arm analysis before deciding that issue.

Accordingly, Magnuson said, "counsel should structure their briefing to address the two inquiries in that order: statutory first, constitutional second."

Meanwhile, Magnuson said he found it interesting that Kaplan initially found that the constitutional due-process standard was not met and then, as part of the long-arm analysis on remand, allowed additional jurisdictional discovery before arriving at the same result.

"Therein lies the oddity," he said. "A defendant was subjected to more litigation in this forum in the form of more discovery, even though Judge Kaplan had decided without that discovery, before appeal and remand, that it would violate the defendant's due-process rights to exercise jurisdiction over the defendant."

Boston attorney Evan M. Fray-Witzer, who handles defamation suits as part of his business litigation practice, said the ruling adheres to what is emerging as the modern view of personal jurisdiction: that the focus must be on the defendant's connections to the forum state as opposed to the plaintiff's connections. The U.S. Supreme Court has emphasized that a number of times in recent cases, and the LevelUp case shows the viewpoint filtering down to the state level, he said.

"A lot of the cases around the country recently have also focused on the idea that the court is supposed to look at the defendant's connections to the state itself and not just the fact that the defendant may have entered into agreements with people who happen to be in the state," Fray-Witzer said.

He noted that that was exactly the situation Punchh faced in that its clients were not based in Massachusetts but simply had opened restaurants here, which was completely outside Punchh's control.

Richard J. Peltz-Steele, a media law professor at the University of Massachusetts School of Law in Dartmouth, said the decision may not make new law but is still significant in that the long-arm statute is potentially narrower than what might be permissible for jurisdiction under the Constitution.

"What struck me was that Punchh was doing business with these companies that had locations in Massachusetts, and that wasn't enough to connect Punchh with Massachusetts," he added. "Even if LevelUp has a physical base in Boston, it's really two entities doing business in the internet ether. And a connection to companies that themselves have locations in various states won't draw an internet company into those states. This may be nothing new, but it's informative to see this play out."

Peltz-Steele further noted that there is a trend internationally to allow jurisdiction to lie where the injury occurs in defamation cases, but the LevelUp case indicates that the trend does not apply in the U.S. and that it cannot apply under the current 14th Amendment due-process analysis.

Alleged defamation

LevelUp, a Delaware corporation headquartered in Massachusetts, designs and markets applications for restaurants to engage with their customers and gather information about customer behavior.

Through use of the apps, customers of LevelUp's clients can earn and redeem rewards at the clients' restaurants while making purchases with their phones at the point of sale.

Punchh, also a Delaware corporation but headquartered in California, provides similar apps to restaurant chains.

According to Punchh, it is not registered to do business in Massachusetts and has no offices, employees or property in the state.

It also maintained that no Punchh employee had ever traveled to Massachusetts for business.

Nonetheless, Punchh, which charges clients a onetime set-up fee before the client can utilize Punchh's app, has contractual relations with a number of restaurant chains that operate Massachusetts locations.

And though Punchh apparently did not track revenue on a state-by-state basis between January 2015 and February 2016 (the time period covering events leading to LevelUp's defamation action), and although Punchh had no input into where its clients established restaurants, it apparently generated $12,000 in revenue attributable to Massachusetts locations during the operative time period.

On Feb. 19, 2006, LevelUp brought a defamation action in Superior Court against Punchh. The plaintiff alleged that, in 2015 and 2016, Punchh made false, disparaging statements to LevelUp clients and kept making such statements, even after LevelUp confronted Punchh and demanded that it stop doing so.

In spring 2016, Kaplan dismissed LevelUp's claim for lack of jurisdiction, citing constitutional due-process grounds. LevelUp appealed, and in November 2017, the SJC found that Kaplan should have conducted an analysis under the long-arm statute before addressing constitutional issues and remanded the case for such a finding.

On remand, Kaplan ordered further discovery on jurisdictional issues. Meanwhile, Punchh moved to dismiss the claim for lack of jurisdiction under the long-arm statute.

Insufficient contacts

Kaplan found there was, indeed, lack of jurisdiction under the long-arm statute.

First, he found that neither Punchh nor its agents were "transacting business" in the commonwealth within the meaning of §3(a) of the statute.

"The court finds no support in [prior] Massachusetts decisions … for the proposition that a non-resident transacts business in Massachusetts because its customer has some contact with the forum," the judge said. "LevelUp makes no argument that Punchh's customers were acting as Punchh's agent in deciding to open restaurants in Massachusetts and then having those restaurants

Continued on page 12

‘In pari delicto’ doctrine doesn’t spare college’s auditor

Financial aid director not ‘sr. management’

By Kris Olson

A college whose financial aid director committed fraud could sue its auditor under the doctrine of in pari delicto, the Massachusetts Supreme Judicial Court has ruled, finding that because the employee was not a member of senior management, her conduct could not be imputed to the school.

After the financial aid director’s misdeeds were discovered, the college sued its auditor for failing to detect the fraud. Superior Court Judge Kenneth W. Salinger granted the defendant auditor summary judgment, relying on traditional principles of agency law.

MULVEY
Counsel for college

In the 2006 case *Baena v. KPMG*, the 1st U.S. Circuit Court of Appeals held that the in pari delicto doctrine barred a trustee, acting on behalf of a bankrupt corporation, from recovering from the corporation’s former accountants for their failure to prevent the fraudulent conduct of the corporation’s senior managers. The 1st Circuit noted that it was not the court’s “job to make new law for Massachusetts.”

In taking a different approach under similar circumstances, SJC Chief Justice Ralph D. Gants found that, “indeed, that job is ours.”

Writing on what he called “essentially a clean slate of Massachusetts law,” Gants said traditional rules of imputation under Massachusetts common law are not without their limits. The rules are inapplicable “where the aim is to assign blame rather than risk,” he added.

When deciding whether punitive damages are warranted against an employer for an employee’s misconduct, a key factor is whether members of senior management participated or acquiesced in the misconduct, Gants said.

“To support an award of punitive damages, a jury must find the employer itself to be morally blameworthy, and that requires a finding that a member of the employer’s senior management was morally blameworthy,” Gants wrote.

For similar reasons, Gants said, under common law, a principal acting through an agent cannot be barred from recovery under the doctrine of in pari delicto “unless the principal is found to be morally blameworthy, and conduct by an agent that is sufficient to hold a principal vicariously liable to third parties will not always be sufficient, on its own, to support that finding.”

Though the employee here had substantial responsibilities, she was not among those primarily responsible for the management of the college, Gants said.

The college’s senior management may have been negligent in retaining the financial aid director or supervising her, which could limit the college’s recovery under the comparative negligence statute, the SJC found. But that conduct did not rise to the level that would bar recovery entirely under the doctrine of in pari delicto.

The 33-page decision is *Merrimack College v. KPMG LLP*.

One lesson: Define scope of engagement

The attorney for appellant Merrimack College, Elizabeth N. Mulvey of Boston, called the decision a “common-sense result,” given that the case involves a professional services organization contracted specifically to discover the type of mistake that had gone undetected.

“It does not seem unfair to hold [the auditor] responsible for not doing what it promised to do,” she said.

Because the court resisted creating a carve-out specifically for auditors, the guidelines the SJC outlined will have broad application, according to Mulvey.

But she said she did not think the SJC opened the proverbial floodgates. Rather, it created rules that sensibly apply to those, like a president or treasurer, who are most able to loot a company by the nature of their positions.

Ian D. Roffman of Boston, counsel for the appellee auditor, did not respond to requests for comment before deadline.

Boston and Framingham attorney Jon S. Barooshian, who regularly represents accountants, said the decision offers a cautionary tale for the accounting industry. His advice for accountants: Be more careful about the scope of audits and who the “players” are.

Though the SJC declined to create an auditor exception to the doctrine of in pari delicto, that is something the Legislature could still do, Barooshian said.

He further noted that the decision does not take the college off the hook for its own negligence, which could ultimately reduce a jury’s award.

As to whether the SJC adequately defined “senior management,” Barooshian said that may be more clear in larger organizations, which have a “C-suite,” and less so in smaller organizations, where employees’ roles may shift from day to day and organizational lines get blurred.

Boston attorney Edward S. Cheng said he was struck by the pains the SJC took to make clear that the BLS judge had not made some kind of legal error but rather that the SJC was making new law.

The court’s justification for the rule it announced is that there always has been a separate test for imputing liability as opposed to assigning blame, and the “punitive part” has always been limited, Cheng said.

“As a practitioner, I’m not thrilled with two tests when one would suffice,” he said.

Cheng added that he struggled with the court deciding that the financial aid director was not a member of senior management, when she had considerable power, including the authority to bind the college to contracts.

In the wake of the ruling, he said, an attorney should be careful about defining the scope of his engagement when conducting an investigation or overall review of an entity client. In certain circumstances, including in an engagement letter a “carve out” that says the lawyer will not be looking behind the numbers or documents it receives to discover intentional wrongdoing may make sense, he said.

Books balanced artificially

From 1998 to 2004, Merrimack College hired the multi-national accounting firm KPMG LLP as its independent auditor. Among KPMG’s duties was to conduct annual audits of Merrimack’s financial statements. It also conducted audits related to the college’s receipt of substantial federal funds in the form of student financial aid.

KPMG’s audits included Merrimack’s financial aid office, which administers various grant and loan programs, including the federal Perkins loan program.

KPMG had on several occasions noted issues with the financial aid office, including delayed reconciliations and other ledger discrepancies, along with a lack of formal policies and procedures relating to the disbursement of grants and loans.

Though KPMG reported the issues to Merrimack’s management, it also ultimately gave Merrimack’s financial statements a clean bill of health and issued an opinion that Merrimack was in material compliance with federal program requirements.

What KPMG failed to discover was that Merrimack’s financial aid director, Christine Mordach, was engaged in a scheme in which she regularly replaced grants and scholarships that previously had been awarded to students with Perkins loans, often without the students’ knowledge or consent. In some cases, she created false paperwork with false names and Social Security numbers.

Mordach’s actions made the financial aid office’s budget appear more balanced, but they also put students on the hook for debt they had neither requested nor even knew they had.

After Mordach’s fraud was detected in 2011, an investigation by an independent forensic accounting team found more than 1,200 invalid or potentially uncollectible loans stemming from Mordach’s activities.

In 2014, Mordach pleaded guilty to federal mail and wire fraud charges, was sentenced to prison, and ordered to pay more than $1.5 million in restitution to former Merrimack students.

Between writing off the fraudulent loans, repaying students who had made payments on them, and conducting its investigation, Merrimack reported having lost more than $6 million. It sought to recover some of the losses by suing KPMG in Superior Court, alleging professional malpractice, breach of contract, negligence, negligent misrepresentation, and violation of G.L.c. 93A.

KPMG moved for summary judgment on four grounds, ultimately succeeding with its argument based in the equitable doctrine of in pari delicto.

Judge Salinger also declined to create a blanket “auditor exception” to the doctrine of in pari delicto, explaining he was following the lead of the majority of courts that had considered the issue.

Merrimack appealed Salinger’s decision, and the SJC granted its application for direct appellate review.

The case now has been remanded to Superior Court, where the defendant’s other three grounds for summary judgment will be considered.

About that ‘auditor exception’

Like Salinger, the SJC declined to carve out an exception to the in pari delicto doctrine specific to auditors as a matter of public policy. Not only was such an exception unnecessary to its decision, but the Legislature in 2001 had enacted G.L.c. 112, §87A 3/4, the court noted.

Under the Legislature’s scheme, if the case gets all the way through trial, a jury or judge will be asked to apportion the fault attributable to each of the parties.

Under the statute, if a plaintiff suffered damages of $1 million, and 70 percent of those damages is attributed to the plaintiff’s own conduct while 30 percent is attributable to the negligence of the auditor, the firm shall not be required to pay more than $300,000.

“By enacting this statute, the Legislature appears to have replaced the common-law doctrine of in pari delicto in cases where an accounting firm is sued for its failure to detect fraud by a client’s employee, with a statutory allocation of damages akin to, but different from, comparative negligence,” Gants wrote.

Neither the parties nor Salinger had cited G.L.c. 112, §87A 3/4, but Gants noted that there “may be relevant conduct that occurred after its effective date and that may be governed by it.” NEIH

New England IN-HOUSE

Publisher
Susan A. Bocamazo, Esq.
sbocamazo@lawyersweekly.com

Editor
Henriette Campagne
hcampagne@lawyersweekly.com

Designer
Anna Otto

Advertising Director
Scott Ziegler

Advertising Traffic Manager & Events Director
Adelle Koscinski

Account Executives
Melanie Footer
Edwin “Buzz” Farquhar
Elaine Fanning

You can view **New England In-House** online at newenglandinhouse.com.

For editorial, call 800-444-5297, Ext. 8192, and for advertising, call 800-444-5297, Ext. 8211.

New England In-House is published quarterly by BridgeTower Media.

POSTMASTER:
Electronic Service Requested.

Send address changes to **New England In-House**, 10 Milk St. 10th Floor, Boston, MA 02108-4649.

Attorneys' fees granted in FINRA arbitration vacated

By Eric T. Berkman

An arbitration panel erred in awarding attorneys' fees to a broker in a wrongful termination and defamation case she successfully brought against the securities firm that fired her, a U.S. District Court judge in Massachusetts has decided.

The broker, Cheryle Anne Brady, claimed her assistant made trades without client consent or her permission, and she ordered him to remedy the situation.

The employer, Ameriprise Financial Services, terminated Brady after she falsely claimed during an internal investigation that the clients had actually authorized the trades.

However, Ameriprise, maintaining that Brady approved the transactions, reported to FINRA that she was terminated "for cause" due to unauthorized trading.

When a FINRA arbitration panel awarded her $675,000 for wrongful termination and another $123,000 in attorneys' fees, Ameriprise sought to vacate in federal District Court.

Regarding the fee award, Ameriprise pointed out that its arbitration agreement with Brady provided only for statutory attorneys' fees and that G.L.c. 93A, §11, the fee-shifting statute that comprised part of Brady's claim, did not apply in the case.

Judge Douglas P. Woodlock agreed.

"The Panel did not have authority to award attorney fees pursuant to M.G.L.c. 93A, §11," Woodlock wrote. "The Supreme Judicial Court of Massachusetts has made clear that §11 covers 'individuals acting in a business context in their dealings with other business persons ...' and 'does not provide a remedy for disputes arising out of an employer-employee relationship. ...'"

Woodlock did uphold the $675,000 wrongful termination award, rejecting Ameriprise's arguments that because one of the arbitrators was a plaintiffs-side employment lawyer, it did not have an impartial panel.

The 27-page decision is *Ameriprise Financial Services, Inc. v. Brady*.

Reasonable award

Peter M. Bizinkauskas of Taunton, who represented the fired broker in the arbitration, said though he respected Woodlock's decision, he thought the fee award was reasonable. In addition to his client requesting fees, Ameriprise requested counsel fees in its own claim to recover balances due on loans the broker had taken out from the company. The promissory notes stated the broker would be responsible for any costs Ameriprise incurred collecting on them.

"Ms. Brady's argument during the arbitration for attorneys' fees was that since both parties requested attorneys' fees … the arbitrators could have reached a reasonable conclusion that [a] de facto parties' arbitration agreement included the award of attorneys' fees to the prevailing party," Bizinkauskas said, noting that the arbitrators dismissed Ameriprise's claim.

Regarding Woodlock's affirmation of the rest of the award, Bizinkauskas said that it is damaging for a broker to have a FINRA Form U5 — the form broker-dealers use to register and terminate associates — state that he or she has been terminated for cause.

"The results of [this case] illustrate that justice may be reached in this forum," he said.

Boston attorney John A. Mangones, who represented the broker in U.S. District Court, said the law is unsettled on whether an arbitration panel can award attorneys' fees absent statutory authority or express agreement, when both parties request fees during a proceeding.

The judge sidestepped the issue here, Mangones said, but the evidence showed that the final figure Ameriprise submitted to the panel for counsel fees included both its counterclaims and defense of Brady's tort claims.

"We were disappointed that the court did not view this as a mutual request for fees on Ms. Brady's claims, but we presently do not intend to challenge the decision," he said.

Ameriprise's attorneys did not respond to requests for comment. But Christine R. Fitzgerald, a Boston attorney who represents clients in FINRA arbitrations and serves as an arbitrator herself, said it was noteworthy that Woodlock refused to overturn the tort award based on Ameriprise's contention that one of the panel members, a plaintiffs-side employment lawyer, was biased.

Ameriprise did not object to that particular arbitrator at the time and did not provide concrete evidence of actual partiality, arguing only that the arbitrator would have a pro-plaintiff bias as a plaintiffs' lawyer, Fitzgerald noted.

Still, she said, if a lawyer is handling a FINRA arbitration and is concerned about the possibility of bias, it is important to look into potential panelists beyond the information FINRA provides.

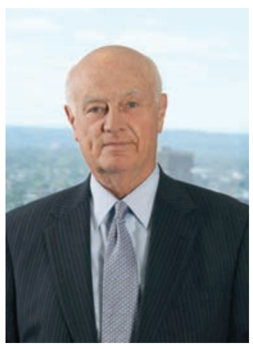
"A Google search or going to a law firm web page will tell you more than the bio that FINRA publishes," Fitzgerald said, adding that each side is asked whether it accepts the composition of the panel at the first appearance.

"You really need to take the time before you answer 'yes' to find out whether there's any reason you may have concerns with any of the arbitrators," she said.

Terminated 'for cause'

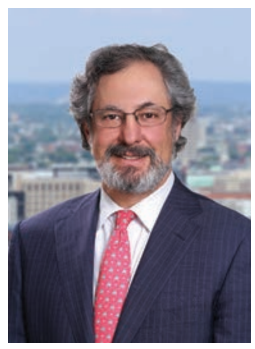
Brady claimed her sales assistant, Bryan Noyes, "went rogue" in June 2016,

Continued on page 13



J. Owen Todd

Christopher Weld, Jr.



Howard M. Cooper

Company can't sue blogger; posts deemed protected speech

By Eric T. Berkman

A water-treatment company could not sue a blogger for defamation over allegedly inflammatory posts he wrote about the company on his website, a U.S. District Court judge in Rhode Island has ruled.

Defendant Brian MacFarland, who blogs about companies that provide consumer products and services, criticized RainSoft and its allegedly high-pressure sales tactics — describing the company as engaging in a "scam" and being "shady" — without distinguishing between RainSoft itself and a local product dealer that purportedly engaged in the tactics in question.

In moving for summary judgment, MacFarland argued that RainSoft could not show he had engaged in the type of material falsehoods necessary to render his comments unprotected defamatory speech.

Judge William E. Smith agreed.

"MacFarland's name-calling — 'scam,' 'shady,' 'magic show,' 'bad logic' — is protected by the First Amendment as 'imaginative expression' or 'rhetorical hyperbole,'" Smith wrote, pointing out that any reasonable reader would understand MacFarland's language as metaphor.

As for MacFarland's failure to distinguish between RainSoft and its dealer, Smith said the "difference between a company and its outsourced foot soldiers — who were 'expect[ed] and count[ed] on … [to] support' the 'organization' they had 'become part of' — is just too fine to have piqued public concern."

The 27-page decision is *RainSoft v. MacFarland*.

Mark W. Freel of Locke Lord in Providence and John M. Touhy of Baker & Hostetler in Chicago represented the plaintiff company. Joseph V. Cavanagh Jr. of Blish & Cavanagh in Providence was counsel for the defendant blogger. Neither of the local attorneys could be reached for comment prior to deadline.

Defamation action

Defendant MacFarland runs the website lazymanandmoney.com, blogging about companies that provide consumer products and services. The website's goal is to save readers money.

In summer 2013, MacFarland and his wife sat through an in-home demonstration of plaintiff RainSoft's water-treatment products. The demonstration was conducted by Gus Oster, a salesperson with RainSoft's local products dealer, Basement Technologies.

Oster used a script that was apparently written by RainSoft and touted the company as a maker of premier water-treatment products. The script also apparently never mentioned Basement Technologies.

The dealership agreement between RainSoft and Basement Technologies stated that the dealer would "protect and embrace" the RainSoft brand "as we all make a living based on its reputation in the marketplace" and that the dealer was expected to promote the RainSoft brand "in every customer facing opportunity." It also stated that all customers purchasing RainSoft products would be considered shared customers of RainSoft's parent company and the dealer.

The agreement further stated that the dealer would promote RainSoft products exclusively unless RainSoft gave it permission to do otherwise, which apparently it never did.

In blogging about the demonstration, MacFarland described Oster as "super nice" but called the presentation a "magic show" that made "false promises" and used "high-pressure sales tactics" and other "slightly deceptive practices."

For example, Oster performed certain acts to show RainSoft techniques purifying the tap water in MacFarland's home. MacFarland, in a blog post, speculated on ways a "devious" salesperson might have been deceiving him with falsely labeled bottles.

Meanwhile, MacFarland blogged his skepticism that RainSoft's filtration system would actually save him $20,000 in appliance-related costs over 20 years as Oster claimed.

In his original post, MacFarland concluded that while RainSoft might not be a "scam," its products were not worth the price.

Eight days later, MacFarland put up a second post describing a conversation with a RainSoft representative in which he haggled $1,000 off the originally quoted price. He also told of a trip to home-improvement superstore Lowe's, where a plumbing rep was "shocked" that Lowe's rival Home Depot, which had introduced MacFarland to RainSoft products, would only connect him with RainSoft rather than showing him a range of options.

Then, before answering his rhetorical question as to whether RainSoft was a "scam" he said he was "leaning toward yes." In a subsequent post, MacFarland definitively defined RainSoft as a scam. And in a fourth post, published a year later, he recounted a spat he had had in the comments section of an earlier RainSoft post on his blog with someone he suspected of, but who had denied, being a RainSoft dealer.

In the exchange, MacFarland discounted the commenter's glowing RainSoft review due to bias, accusing the commenter of engaging in a "comment scam" while rehashing his previous complaints about the company.

Meanwhile, the comments section on each of MacFarland's four RainSoft posts showed him commenting back dozens of times, usually to concur with those who agreed with him while trading barbs with those who did not agree.

In April 2015, RainSoft sued MacFarland in U.S. District Court for defamation. RainSoft also claimed violations of the federal Lanham Act for false advertising. Specifically, RainSoft alleged that MacFarland was unfairly competing with the company by relying on false statements of "scams" and "magic tricks."

After the suit was filed, MacFarland put up a fifth blog post entitled "What is a Scam Anyway?" In it, he explained that when he used the term "scam" he was not necessarily suggesting illegal activity but rather a "confidence trick."

Discovery allegedly revealed that he wrote that post to cover himself against potential libel claims. Additionally, discovery revealed that he had known that the dealer and RainSoft were different companies, and that Oster worked for the dealer and not RainSoft, before he had written a couple of the posts in question.

Not materially false

Smith found that RainSoft had no actionable defamation claim.

The judge observed that many of MacFarland's allegedly defamatory statements — such as his characterization of RainSoft being a "scam" and "shady" and engaging in "magic tricks" — fell under the broad category of "epithet" that could not be shown as both defamatory and false.

Instead, he said, such statements, based on loose, figurative language that no reasonable person would see as factual, could not be proscribed under the First Amendment.

"Even before glimpsing Internet poetics in full bloom — the Facebook rants, Twitter meltdowns and Instagram shade — the First Circuit recognized 'the reality that exaggeration and non-literal commentary have become an integral part of social discourse,'" Smith wrote, quoting the 1st U.S. Circuit Court of Appeals' 1997 ruling in *Levinsky's, Inc. v. Wal-Mart Stores, Inc.* "'[T]his category of speech,' these '[c]asually used words,' are not actionable … 'no matter how tastefully couched.'"

Other statements MacFarland made were protected by other First Amendment "overlays," the judge said.

For example, he said, the First Amendment protects "statements of public concern" that would cover issues such as water safety, sales tactics, and the efficacy of various filtration systems.

"And MacFarland's opinions to which RainSoft objects here — including the charge of 'false promises,' 'high-pressure sales tactics,' and 'slightly deceptive practices' — are all accompanied by their factual bases," Smith said.

As for RainSoft's argument that MacFarland should be held liable for failing to distinguish between RainSoft and its dealer in his posts, Smith said the dealer was "basically a "de facto arm of RainSoft" and the fact that the two were legally separate entities was meaningless to the "web-surfing public."

Finally the judge rejected RainSoft's claims that MacFarland should be held liable for false advertising under the Lanham Act.

"RainSoft's Lanham Act claim fails because … the only product MacFarland can be said to have sold readers is his advice, which they got for free," Smith said. "Not only is there no evidence to support a finding of the requisite intent to sell, it is not at all clear that MacFarland's posts even constitute commercial speech."

Accordingly, the judge granted summary judgment on all counts. NEIH

Private Equity and Venture Capital:

A Roundtable Discussion

Transcription services provided by O'Brien & Levine Court Reporting • Photos by Mike Ritter

Daniel Avery
Director, Goulston & Storrs

Matthew Epstein
Director, Goulston & Storrs

Julie McCann
Associate General Counsel, Battery Ventures

Jonathan Stein
Counsel, Goulston & Storrs

Alexander Weiss
Principal, Charlesbank Capital Partners

DANIEL AVERY, GOULSTON & STORRS: I'd like to hear from the panel about what they're seeing in their respective areas in terms of hot buttons at target companies. What are becoming big issues when you're looking to invest or acquire or sell a company?

ALEXANDER WEISS, CHARLESBANK CAPITAL PARTNERS: Probably the biggest trend we're seeing right now is that markets continue to be on fire, and the availability of leverage for transactions continues to go up. It's as high as it's been, certainly since the recession, and potentially even before that.

As a result of that, the prices for LBOs continue to come up. The biggest challenge we face every day is how do you find opportunities to buy good businesses at attractive prices?

We're looking for businesses that have stability heading into a recession. It's been a very long period of strong economic growth. And we're thinking about our models, we're thinking, "How do you find a business that performs reasonably well, is fairly non-discretionary, is not something that's going to drop off a lot in a recession?" Because if you're borrowing a lot, and then you hit a downturn, you could have a lot of negative effects from that.

AVERY: Are you seeing particular industries that are of unique interest or disinterest now, and how are you seeing the mix of financial versus strategic competitive bidders when you're looking to buy?

WEISS: Most sectors right now are fairly highly priced. I think there are a couple of exceptions to that. One would be traditional retail businesses, which are trading at much lower levels, but have major threats from e-commerce. The other sector is energy, [which] has been up and down a lot over the last couple of years with oil prices.

> "The biggest challenge we face every day is how do you find opportunities to buy good businesses at attractive prices?"
>
> **— Alexander Weiss, Charlesbank Capital Partners**

I spend a lot of time working on service businesses, distribution businesses, consumer businesses, and all of those sectors are at historic highs in terms of the multiples we're looking at. As it relates to sponsors and strategics, once you're in the middle of a process it tends to be much more of the sponsors, because it's very difficult for a strategic to be able to compete from a speed standpoint. The trend is that processes are much faster from beginning to end than they were even three, four or five years ago. [From] an initial management meeting to the time when bids are due is maybe a six-, seven-week process, whereas that might have been, 10, 11 weeks before. And bidders need to come with a signable contract in a short period of time in order to be competitive there. In those types of instances, it's usually really difficult for strategics, which generally move more slowly in a transaction context, to be able to make decisions that fast.

AVERY: What's interesting to hear is that the strategic bidders are potentially at a disadvantage because they're not set up internally to move as quickly as the financial sponsors are able to do.

WEISS: We have a number of foreign buyers who are looking to get into the U.S. They typically will hire an investment banker or some sort of M&A advisor who's very familiar working with U.S. private equity firms and then make a preemptive bid in advance of a process to a private equity owned company. If you can do that, then from our standpoint, we're much better able to accommodate a longer timeline or shareholder votes or other things. But if you wait until a business is for sale, that's much more difficult, particularly for non-U.S. buyers who don't have a lot of experience in the U.S.

JULIE MCCANN, BATTERY VENTURES: I'll focus a little bit more on the venture capital side of things. In the VC context, we're still seeing really competitive deals, very high valuations. Everybody just has so much capital out there.

My perspective is a little different because I'm not on the investment team side. I'm just a lawyer who's supporting my internal clients. But from my perspective, valuations are incredibly high. I've had to deal with antitrust analysis in the U.S maybe five or six times this year, which is a sign of the price of things. Maybe in the five years before that, we looked at antitrust analysis just a few times.

So prices are high, things are competitive, and our team needs to stay disciplined, because you still need to have a return that's respectable, even if it's a fantastic company. People are trying to get creative. We're doing a lot of investing in Europe, because I think people generally see that there's a little more value to be had in Europe.

[From] a legal perspective, one thing I think has changed is [that] when it was really competitive, maybe two or three years ago, and the prices were crazy you were seeing one-page term sheets that just said, "Here's a check for $100 million," and really no other terms. [Now] we're seeing terms come back. We're seeing real term sheets and controls and downside protection.

AVERY: In terms of some of the business items, are you seeing the impact of the tariffs and the trade wars with China?

MCCANN: So many of our companies are software companies. They don't make things. The biggest thing has been the immigration policy shift, because so many of our founders are immigrants, and it's so important for the VC ecosystem to have that welcoming environment and not the environment we're in now. Our companies are having trouble encouraging people to come, convincing them that it's not a hostile place, that when they get their family established that they can stay. I think that the resurgence on H-1B Visas, things like that, have really had the most impact [for] the early and ground stage companies.

WEISS: From our standpoint [there are] two things I would highlight in terms of the current administration. One [is] a loosening of regulations around some of the standards on lending and the scrutiny on investment banks in terms of how much they can lend and what types of ratios can be out there. It hasn't had a major shift, but it's definitely moving in the less regulation direction. A second [is] the tariffs. It's definitely company by company, but we have a number of businesses that [are concerned] in terms of how that's going to ripple through.

> "In the VC context, we're still seeing really competitive deals, very high valuations. Everybody just has so much capital out there."
>
> **— Julie McCann, Battery Ventures**

Is it going to affect their margin? If all of your end customers are paying more for all kinds of things, does that have an impact on consumer spending?

AVERY: There's been more uncertainty because a lot of the changes that have been implemented by the current administration are by executive order and not by Congress. So a lot of these things could be unwound by a new president easily.

That said, we have been seeing some impact of the tariffs for manufacturing companies. On the immigration front, we've seen a high degree of sensitivity at the founder level, particularly in the tech sector, because of the contribution that immigrants in that area provide.

The other thing we've seen a little bit of is the sense that the federal government may be pulling back in some areas, like environmental. We're seeing states in the U.S. at least make noises that they either will or will not be stepping up to meet that void.

We've definitely seen things around the edges: not cratering deals, yet creating some concerns. I haven't seen it necessarily impact values yet, but there's definitely aspects of diligence and discussion amongst investors and targets that have changed a little bit in the past few years.

AVERY: For a longtime, wage and hour issues were huge, [as were] noncompete issues in California and Silicon Valley. Recently, with the #MeToo movement and the sensitivity around that, what are you seeing?

MCCANN: They're not necessarily shareholder directives, though I know that we have some co-investors where in their standard documents now they say you will have and you will implement and you will comply with anti-harassment policies. It's going into term sheets now. Companies are doing things like that because of the climate and because it's the right thing to do. But I haven't seen anything come up in diligence. I haven't been asked, "Does this company have an anti-harassment policy?" as part of a document request.

WEISS: It's not something that necessarily explicitly shows up in a lot of diligence, but it's something where [we] certainly make sure all of our portfolio companies have tight policies around that, and that we're seeing a diverse pool of candidates when we're doing senior executive searches.

AVERY: Let's talk a bit about some of the things that impact cross border investments and acquisitions from a tax perspective.

"But now that we've had U.S. tax reform, I think what we're going to see is a shift back to people using corporate blockers."

— Jonathan Stein, Goulston & Storrs

JONATHAN STEIN, GOULSTON & STORRS: We had major tax reform at the beginning of 2018 here in the U.S. Obviously, it's wide-ranging reform, and there's a lot of small things and large things that may or may not affect different taxpayers. When companies invested in the U.S., the most traditional structure was a corporate blocker. The reason why we call it a blocker is because it blocks a lot of U.S. tax obligations by using a corporation as opposed to using a transparent entity.

The blocker would have leverage, so it would be capitalized with both equity and some shareholder debt as well. The reason for that is the U.S. corporate tax rate was 35 percent, which was relatively high relative to other worldwide corporate tax rates in developed economies. And the use of leverage allowed base erosion techniques. So the U.S. income tax base would be reduced because the U.S. company would be able to make these interest deductions.

A similar concept was used with respect to intellectual property where royalties would be paid for related party licenses, and that would also be used to reduce the U.S. tax base and reduce the effective rate of tax to get that 35 percent rate down to a more palatable rate that was more competitive globally.

Those techniques worked well. But on venture capital investments or other smaller investments, people began to invest in the U.S. using more transparent entities, closely held entities. People became more comfortable with limited liability companies and limited partnerships and other types of flow-through entities. Those entities had a few advantages. One of the big advantages — again, this is all under the old regime — is that the rates were a little bit lower. The combined rate on ordinary income and capital gains versus the rates on corporate income plus dividend rate was lower. It also let flow-through of losses. So if you're investing in a startup, and you don't expect it to have real profits until three to five years out, you might want the ability to take advantage of those losses and not have them trapped in the U.S.

But now that we've had U.S. tax reform, I think what we're going to see is a shift back to people using corporate blockers, and that's for a few reasons. One, the base erosion is less important and less attractive. With the U.S. corporate tax rate at 21 percent, it's possible that the home country rate of the investor will be higher. So you're not really gaining anything by moving that income from one jurisdiction to another.

AVERY: By that, you mean that there is less of a tax-related impact from inter-company financing and IP licensing?

STEIN: Yes. [You don't have to] capitalize the company and [have] the need for leverage and the need for related party licensing and things like that.

So, corporate rates are now 21 percent. The individual top rate is 37 percent. Individuals can also potentially benefit and lower that 37 percent rate with a 20 percent deduction. That applies to certain pass through income, and non-resident aliens are eligible for that deduction.

We tend to focus on businesses and scale, but if an individual investor is actually making an investment, they would have to look again to see whether a flow-through is worthwhile, because they might get the benefit in certain industries of this 20 percent deduction. Outside of a really small individual investment like that, I think blockers will be more popular again ... because of the lower rates.

[The other] reason why it's important perhaps to be in a blocker, as opposed to a flow-through, is that there now can be U.S. withholding tax on the sale of the equity of the flow-through. So if you sell an LLC membership interest or if you sell a limited partnership interest from your Delaware limited partnership or your Delaware LLC, when you sell one of those types of flow-through entities, it's treated as if you had sold the underlying assets, and U.S.

withholding tax can apply, whereas when you sell stock, there's generally not any withholding tax.

AVERY: What about repatriation type issues that come out?

STEIN: One of the issues is a one-time repatriation tax that we have now in the U.S. It was very common for companies who had active foreign income to keep that cash offshore and not bring it back to the U.S., and that was because they would pay a tax when they brought it back to the U.S.

With the tax bill, we now have a one-time sort of de-facto repatriation. What that means is all the companies are now treated as if they had brought the cash back, whether or not they did so, and will have to pay taxes on that cash as if they had brought it back.

That could create diligence issues. We're dealing with it now in M&A where we have a U.S. company that has a Canadian subsidiary that is a very traditional company that makes things,

"A much higher percentage, relative to the past, of our investments are now in Europe or Israel or recently Australia, which is new for us."

— Julie McCann, Battery Ventures

and they have a lot of cash from their manufacturing in Canada that they kept in Canada and used in Canada. But now, they have to pay U.S. tax on it, and the sellers and the buyers have to allocate that tax liability.

AVERY: Are [you seeing] many deals ... in Europe or China or other [places outside of the] U.S.?

MCCANN: A much higher percentage, relative to the past, of our investments are now in Europe or Israel or recently Australia, which is new for us. And [we're seeing] more U.S. firms. We're seeing them in our syndicates and we're competing for deals against them, where that was probably not the case recently. I met with a lawyer from the UK a few weeks ago, and he was saying the same thing: that they're seeing more U.S. firms either trying to establish a presence there or just trying to invest from their headquarters here.

WEISS: We've always been active in Canada. We're for the most part not doing a lot of dedicated investing in Europe. But a lot of our larger competitors have a dedicated European fund or a dedicated Asian fund and are investing there. And in some cases, they have global funds and look across borders.

MATTHEW EPSTEIN, GOULSTON & STORRS: Is there an industry that is growing right now?

McCANN: I'm going to be biased because we only invest in technology. But there's an expression that software is eating the world. There's a software solution for every problem, and you just need to find the right company that's solving that problem and has the software to do it. I think aside from that, anything related to crypto people are getting interested in.

That's the area that I think will be most interesting to watch, because there are smart people who are saying this is the future, [and] smart people who are saying be careful of this. The regulatory landscape is very unclear at the moment. The government is trying to wrap its head around crypto technology at the same time as investors, and everybody is a little bit behind the people who are working on it. I would say that's probably going to be the biggest game changer.

AVERY: What are you seeing at the lower end of your enterprise values in terms of sectors that are kind of hot or not?

WEISS: Technology and software is affecting more and more businesses. It's not so much a

Continued on page 22

Continued from page 21

sector anymore, but something that kind of goes across everything. On a smaller scale, there's lots of distribution businesses and service businesses that were historically very local on a regional basis that have been in the earlier stages of consolidation. Private equity has spent a lot of capital consolidating distribution and service businesses.

"A lot of the deregulation we're seeing in the U.S. has been an attempt to pull back or dismantle large, existing bureaucratic institutions."

— Daniel Avery, Goulston & Storrs

AVERY: There are very new financial services, like crowdfunding, that are taking over projects more locally. What is the approach that you foresee your firms will have?

MCCANN: I think that we will see regulation. I don't think this is an area that is going to be deregulated. The SEC is trying to be cooperative with the people who are creating these technologies and investing in these technologies so that they don't stifle all this innovation, but they've been pretty clear that you're going to need to be in the realm of securities laws.

STEIN: With respect to crypto currency and Bitcoin, if the SEC is behind, the IRS is even further behind, and there actually is a piece of tax reform that's relevant to this. The IRS's view is that crypto currency is property, not currency under the tax law, and so all the special rules that apply to currency traders don't apply to crypto traders.

You [will] see change with respect to the cannabis industry. The banking issues have not been solved. The tax issues have not been solved. It's still a Class 1 substance federally, which means that you can't have any normal trade or business deductions, so they're effectively taxed on their gross sales from inventory. They can only exclude cost of goods sold, not other expenses.

AVERY: A lot of the deregulation we're seeing in the U.S. has been an attempt to pull back or dismantle large existing bureaucratic institutions. I don't necessarily think that's going to mean that new risks or consumer risks won't be regulated.

AVERY: Bubbles can burst. I think memories are short. In 2008 and 2009, we said it would never happen again. Julie, how do you see Battery looking out toward the future in the context of technology bubbles?

MCCANN: I'm sure every investor says this, but that's why you try to be uniquely disciplined

"If foreign clients would like to be in the best position to seek American private equity, are there things that they can do so that the private equity firms' brains won't explode when they do due diligence?"

— MATTHEW EPSTEIN, Goulston & Storrs

on the way in and just not invest in the companies that you think are just benefitting from a bubble, even if you love the company, because you can see down the road that part of the return analysis is, even if things go awry, could we at least get our money back at this valuation. I think you just become a very long-term investor.

WEISS: From a micro standpoint in terms [of what] we think about underwriting our investments, we'll typically assume if we're buying something for 10 times today, we assume that we're going to sell it for nine times in the future, all else [being] equal, just because we have some inflation in where we are, and I think a lot of that comes to the leverage markets.

It's easier to get cheap debt today than it has been really at any other time in history, and that's not going to be available over a long sustainable period of time. So even if the fundamental business is the same, if you're borrowing six times versus seven times, that's going to affect the multiple. That's how we think about it on an underwriting basis, but I think from a broader economy standpoint, you certainly are seeing short memories [about] a lot of things. You're definitely not seeing a lot of caution like you would have five years ago.

EPSTEIN: If foreign clients would like to be in the best position to seek American private equity, are there things that they can do so that the private equity firms' brains won't explode when they do due diligence?

WEISS: Having a local buy side advisor is often very helpful, [someone] who's just very familiar with what our expectations would be in the market, and so they can often be very helpful in facilitating that process.

From our standpoint, we are often much more open to entertaining a potential buyer of one of our businesses. If it's outside of a process, you have a clear timeline of what it's going to look like you get. A typical process would be you might get a little bit of information, a company evaluates it, and then once you agree on a price and an LOI, you've got something like 30

days to go and do the work, and you'll have kind of unfettered exclusive access to the company during that period. And if you have a very high conviction that the transaction is going to get done, then our interest in pursuing that is much higher. If it feels like it's more of a fishing expedition, then we would try to suss that out earlier.

Often, you can tell based on who are the advisors that they've engaged. Are they spending money on legal and accounting? Are they asking the types of questions that suggest they know the business, they know what they're getting into? If they kind of come in and say, "We want to get into the U.S. market in some capacity. We're not sure how. Tell us about your business," that's much less exciting.

If they say, "We know you guys, and we've been looking at targets for a while, and we think you're the right target, and here's why and let us kind of go through and make sure that your books are clean," that case is the one where you have much higher odds of kind of getting access to the company to be able to do that.

MCCANN: If you're talking about taking U.S. money for an investment or an acquisition, I think from our perspective we try to adapt to the local norm. So we wouldn't come in and be the big U.S. fund with our exact formal purchase agreement and U.S. terms and expect to see the diligence look exactly how it would for the most buttoned-up U.S. company.

We would hire somebody local who would talk to you as local counsel and be able to identify whether things look good, whether they're using good forms of employment agreements, whether their leases are fine, whether they have a bunch of customer contracts with crazy indemnification terms. But we'd really rely on local counsel to translate and say this might look messy to you as a U.S. person [but] here, this is pretty common for a company this size. Or [conversely,] this looks pretty messy, it looks like their CFO did everything [and] they never used outside counsel until they were trying to get an investment or trying to get sold. [Or] this lawyer is good, but they haven't been there along the way.

It's sort of the same as in any deal, except that you're using local counsel to say things look pretty good or this is going to be a haul to try to get due diligence.

Sharing management communications with auditors

Joseph J. Floyd

The federal securities laws provide an added incentive for corporate officers at pubic registrants to be transparent and honest with their representations to their company's auditors.

In fact, if a corporate officer lies, or simply omits to tell an auditor a material fact that makes other information misleading, he or she may receive up to 20 years in prison or $5 million in penalties, or both.

The most relevant provisions of the federal securities statutes and regulations regarding interactions with auditors are as follows:

17 CFR 240.13b2-2 — Representations and conduct in connection with the preparation of required reports and documents.

(a) No director or officer of an issuer shall, directly or indirectly:

(1) Make or cause to be made a materially false or misleading statement to an accountant in connection with; or

(2) Omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with:

(i) Any audit, review or examination of the financial statements of the issuer required to be made pursuant to this subpart; or

(ii) The preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.

The penalties for violating 17 CFR 240.13b2-2 are found in 15 U.S. Code §78ff — Penalties, and are as follows:

(a) Willful violations; false and misleading statements

Any person who willfully violates any provision of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder … shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $25,000,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

Interestingly, though these laws arose out of the Sarbanes-Oxley Act of 2002, their prosecutorial application over the years doesn't appear to match the number of matters brought by the U.S. Securities and Exchange Commission that allege the misrepresentation of facts or withheld information from auditors by corporate officers.

However, recent actions applying the "lies and omissions to auditors" laws against corporate officers have appeared, including the recent case described in the SEC's Accounting and Auditing Enforcement Release, or AAER, against Philip R. Jacoby Jr., the former principal accounting officer of Osiris Therapeutics, a publicly traded biotechnology company.

Jacoby pleaded guilty to violating 17 CFR 240.13b2-2 in an action filed in the Southern District of New York. Per the release, Jacoby was sentenced to two years of supervised release and ordered to pay a criminal monetary penalty of $10,000 as a result of his conviction. In addition, following his plea, the SEC suspended Jacoby from appearing or practicing before the SEC pursuant to Rule 102(e)(2) of the SEC's Rules of Practice.

For legal counsel who serve corporate officers of public registrants, an overview of the Jacoby case and a discussion of best practices for identifying relevant information to share with auditors are useful to avoid corporate officers being second-guessed regarding their communications with auditors.

Osiris is a biotechnology company that researches, develops and markets products for orthopedics, sports medicine, and wound care. Per the SEC complaint, for the seven quarters ended Dec. 31, 2015, Osiris and its former senior officers engaged in fraudulent activities to inflate their reported revenue.

Per the SEC, in connection with one distributor in possession of consignment inventory, Jacoby caused Osiris to recognize revenue of over $1 million for a purported sale in the fourth quarter of 2014, even though the transaction was not finalized until January 2015.

Of note, Jacoby allegedly solicited a customer to buy the goods maintained at the distributor in December, expressing cooperation on favorable sales terms during December 2014, but the customer didn't respond until January 2015. The customer agreed to the sales terms and produced documentation as if the purchase occurred in 2014.

To make matters worse for Jacoby, the Public Company Accounting Oversight Board subsequently inspected the work papers of Osiris' auditor, and the auditor asked Osiris for additional support related to the timing for this transaction's revenue recognition in December 2014.

Per the SEC, to fulfill that request for the auditor, Jacoby conspired with the customer to provide such additional support. According to the complaint, Jacoby prepared a letter backdated to Dec. 29, 2014, to memorialize sales terms as of that date.

Next, Jacoby used his personal email account to send the letter to the customer and stated:

"attached is something that I think you should find and send to me in an email saying you had this in your file from late last year, and just came across it — and that it does memorialize our several phone conversations … . Call me if necessary, but write a wonderfully warm and convincing email, please — send it to my Osiris email."

Upon receipt of the fabricated letter from the customer, Jacoby forwarded the information to Osiris' auditor.

Needless to say, situations such as Jacoby's fraudulent letter are clear violations of the law. The more difficult situations for corporate officers arise when making ordinary course judgments about what, how much, and when to share information with auditors to avoid allegations, made with hindsight, that the officers have been less than forthright or even acting in a misleading manner with auditors.

From the initial planning phase and throughout the audit, transparent discussions enhance an auditor's trust in management and avoid misunderstandings that may be perceived as violations of the law. Best practices for corporate officers in response to the major communication questions are described below.

- **What should be shared with an auditor?**

There really is no reason to guess or speculate as to what should be shared with an auditor. The easiest approach is to ask during the planning stages for the audit. Of course, the auditor may give an answer that's overbroad and vague. In that case, there are a few simple guide posts that can be established, and all relate to areas of risk for establishing the financial statements are free from material misstatement.

First, major considerations in forming financial statement ordinary course estimates, assumptions and judgments are important to share. Examples may include bad debts reserves, percentage of completion accounting and sales returns allowances. In contrast, matters related to the simple accumulation of transactional information such as payroll records or selection criteria for vendor payment timing are of less consequence.

Second, communicate matters that make the closing process and producing financial statements laborious or stressful. Examples may include correcting divisional accounting reports submitted to headquarters, or financial reporting matters discussed but not recorded on the financial statements. The latter category would include accrued expenses that management deems less than probable to occur, so no current period expense is taken. Similarly, not writing off assets but acknowledging there may be some question about the strength of the asset's recovery or conversion into cash is also an accounting judgment to share with the auditor.

Third, share what's new, different or changed related to business and sales practices. Accounting and financial reporting is a language for reporting business results and can be done properly only when all the facts are taken into consideration. New sales programs, changes in accounts receivable terms, or entering into distribution agreements would all be examples of matters to be shared with the auditor.

- **How much information should be shared?**

For starters, management should share

Continued on page 13

Joseph J. Floyd, a CPA and attorney, is president of Floyd Advisory, a consulting firm in Boston and New York City that provides financial and accounting expertise in the areas of business strategy, valuation, SEC reporting and transaction analysis.

Examining fiduciary confusion: states, entities and illogic

Stephen M. Honig

This column examines the confusion in understanding fiduciary obligations of owners and managers of certain types of entities in different states, specifically Massachusetts and Delaware.

Recognizing the different state judicial histories, and that law requires applying general principles to varied facts, the problem is with two different state legal schemes, and three different primary entity types (corporation, limited liability company and partnership), confusion remains over who owes what fiduciary duty to whom.

Massachusetts law

In Massachusetts closely held corporations, both majority and minority shareholders owe each other a fiduciary duty, the same duty of "utmost good faith and loyalty" owed to partners.

Even business decisions that make economic sense cannot harm another shareholder unless there is no practical "less harmful alternative."

The definition of a Massachusetts closely held corporation has been generated through case law: entities with a small number of shareholders, illiquid stock, majority participation in operations. (The Massachusetts case law has developed differently with respect to more broadly held corporations.)

Fiduciary obligations owed to a corporation are long-lived. Even shareholders who have been expelled, and shareholders in a dissolved corporation, run into fiduciary problems when they attempt to compete, taking to themselves the goodwill of the enterprise. Lack of legal clarity in cases of dissolution can bring former shareholders seeking to compete with a defunct corporation to the courthouse steps.

Massachusetts fiduciary duties attach only to entities formed in Massachusetts; governance of entities traditionally follows the law under which that entity was formed. So two corporations working down the street from each other in Framingham, with identical fact patterns, may receive completely different legal treatment.

We lawyers have come to accept that as logical, but as a matter of public policy it may make little sense, except in cases in which entity selection was purposefully selected for that very fiduciary result.

Although in Massachusetts parties can (to an extent) alter fiduciary duties by expressly addressing behavior by contract, the contract will be closely construed so as to control the results only in situations that are specifically addressed.

These agreements inter alia may affect buying or transferring of shares, entitlement to employment, and handling of corporate opportunities. But even in matters covered by contract, oppressed Massachusetts minorities still enjoy protection through the implied contractual covenant of good faith and fair dealing. How one might apply that covenant to an oppressive contractual term is difficult to predict.

The Massachusetts LLC was invented by statute with the express purpose of providing certain corporate attributes, including liability insulation and flexibility in equity structure, to partnership-like entities.

LLCs in Massachusetts rest heavily on Massachusetts partnership law. An LLC, as well as a partnership of any type, may create great fiduciary obligations, echoed in a closely held corporation.

Delaware law

The story in Delaware is different. There, a "close corporation" is specifically defined by statute, with express limitation on the number of shareholders, and requirement that all stock be restricted from transfer.

The "close" designation requires an express adoption of that statutory status. If you don't elect it, then no fiduciary obligations are imposed on any shareholders.

Further, forming a Delaware close corporation does not automatically place you into a fiduciary scheme such as in Massachusetts, see Subchapter XIV of the Delaware General Corporation Law. The close corporation also must elect to establish specific fiduciary obligations.

But even in Delaware corporations that are not "close" and that have not elected to contract for fiduciary ground rules, equitable principles imposed by Delaware courts prevent certain oppressive majority action.

Under longstanding case law developed in respect of larger and typically public corporations, where majority shareholders self-deal, they can be held to the "entire fairness test," which specifies exactly what must be done by a controlling majority to undertake a transaction allegedly detrimental to minority shareholders. Delaware courts thereby created a limited fiduciary standard in M&A and related practices.

The requirements for authorizing a business transaction involving the controlling shareholders are complex and much-litigated. The confusing illogic of the evolving multiple layers of required process for authorizing various transactions has been previously addressed in this column, but suffice it to say that a majority in a Delaware corporation may bear the burden of proof that a transaction meets standards of both due process and economic fairness. This requirement can be applied not only in M&A, but in restructurings and similar circumstances.

Some comparisons

First, note an odd juxtaposition. In Massachusetts, the case law imposes fiduciary duty on smaller corporations but not generally on larger ones. In Delaware, absent an express statutory election, there is no case-law-imposed fiduciary duty on smaller corporations, but there is an analogous type of de facto fiduciary protection for oppressed investors in larger corporations. (This difference likely just reflects the kinds of corporations most typically formed, or litigated about, in these jurisdictions.)

Another distinction between the states relates to termination of minority shareholder employment. Absent a controlling employment agreement to the contrary, firing a minority shareholder from employment in Massachusetts may constitute a breach of fiduciary duty, but such is not the result in Delaware.

Further, under Delaware law, minority shareholders never owe fiduciary duties. They can be liable for theft, for fraud, for unauthorized competition, for a myriad of common law offenses. But any such failing must be asserted derivatively, and no duty is owed by the minority directly to the majority.

I have touched on the law relating to limited liability companies and partnerships. Practitioners know that they can write into an LLC's operating agreement, or a partnership agreement, wide fiduciary flexibilities not likely tolerated in a corporate setting — even provisions permitting actions that otherwise would breach fiduciary duty. And indeed, historically, many partnerships that were designed for a particular opportunity (developing a product or a particular parcel of real estate) might contain statements that all participants have the right to undertake other similar ventures or seemingly competitive ones.

But even in Delaware LLCs, if an operating agreement is not drafted specifically, then in the words of Section 18-1104 of the Delaware LLC Act, "the rules of law and equity … shall govern."

In Delaware, limited liability companies operated more like corporations (with managers and passive non-managing members), or operated more like a partnership with member management, may find that courts will apply corporate or partnership standards (as analogous) to fiduciary breach questions (see the Aug. 21, 2018, Chancery case of *Goddin v. Franco*).

The startup

Startups are an integral part of Massachusetts business culture, achieving almost iconic status.

We have seen that state for formation, and form of entity, can have material effect on fiduciary rights. Would you not expect that entrepreneurs would pay attention to these issues in selecting a state of formation and form of entity? Particularly since startups are highly volatile, and founders come and go for a variety of reasons? Lawyers in this space know that logic gets no practical traction.

Many startups are documented by founders themselves, or by services providing a standard package with minute book and bylaws. Many startups are formed based on an expectation that investors want a tax flow-through entity or not, or based on the financial goals of the entrepreneurs themselves, or on presumed investor preference for Delaware.

Entrepreneurs also are in an enormous hurry and lack tolerance for legal stuff, deemed not essential to perfecting their new algorithm or pharmaceutical.

Even when lawyers are consulted, founder reaction is that they are wasting time documenting what happens if things fall apart. Further, lack of money to compensate counsel leads to poor practice. When there are multiple persons involved in forming a new business, and the lawyer suggests that each needs separate counsel because interests differ, eyes begin to roll upward. The only thing less desirable to a startup than having one lawyer is having several.

The solution

The solution may be difficult but is clear: standardization of fiduciary rules across states and types of entity.

Given the way entrepreneurial entities are formed based on substantive business reasons having nothing to do with fiduciary issues, could we not benefit from having uniform fiduciary standards (subject only to specific drafting to the contrary)?

We could establish for all entities what the majority owes the minority; what if anything the minority owes the majority; how transactions creating conflicting economic interests are authorized regardless of type of entity; what happens when an equity holder is "fired" without an employment agreement; and what happens on dissolution.

Since selection of state and form of entity is driven by extrinsic issues and not fiduciary considerations, the answer should be clear.

If all else fails in enticing a cross-border agreement, cannot at least Massachusetts alone adopt an omnibus provision providing that, among different Massachusetts entity forms, equal facts create equal fiduciary ground rules? NEIH

Stephen M. Honig practices at Duane Morris in Boston.

Defamation suit against California company fails

Continued from page 3

employ Punchh's app."

Similarly, Kaplan found no jurisdiction under §3(c), which he described as being meant to apply only when the act causing injury occurs within the commonwealth.

"In this case … there is no allegation that Punchh's offending statements were delivered into the Commonwealth or that anyone relied on them in the Commonwealth," the judge said.

Finally, Kaplan found that §3(d) of the long-arm statute, which creates jurisdiction over acts outside the commonwealth by those regularly soliciting business or deriving substantial revenue by providing goods and services in Massachusetts, did not apply.

In particular, the $12,000 in revenue that could be traced to non-Massachusetts clients' Massachusetts operations was not enough to establish jurisdiction under §3(d), he said.

Accordingly, Kaplan concluded, Punchh's motion to dismiss for lack of personal jurisdiction should be granted. NEIH

Attorneys' fees granted in FINRA arbitration vacated

Continued from page 5

engaging in securities trades for clients without consulting them as required.

She said she learned of the trades soon after, questioned Noyes, and ordered him to "fix this."

Ameriprise, however, concluded after an internal investigation that Brady directed Noyes to make the trades and, on Sept. 7, 2016, fired her and filed a U5 termination form with FINRA stating that she was fired for cause because of unauthorized trading.

In October 2017, at the close of FINRA's investigation, Brady signed a letter conceding that she had lied to Ameriprise's compliance department during its internal investigation before she was fired. She had apparently told compliance that she had talked to the clients the day of each trade and told Noyes to make the trades, while later telling her assistant manager that he entered the trades without her knowledge.

Pursuant to the arbitration provision in her employment agreement, Brady brought claims before FINRA for defamation and wrongful termination. Ameriprise, in response, sought to recover unpaid balances for loans Ameriprise had made her against her salary, an apparently common practice in brokerage firms.

The panel awarded Brady $675,000 in wrongful termination damages and $123,000 in attorneys' fees while ordering that the U5 be changed to state that Brady was terminated "without cause" and that there was no credible proof that she had authorized the trades in question, which ultimately benefitted the clients.

Ameriprise then filed an action in U.S. District Court to vacate the ruling.

Award in error

Woodlock upheld the wrongful termination award, unpersuaded by Ameriprise's assertion that because it did not learn of arbitrator David Summer's plaintiffs-side employment work until after the award, it was deprived of a fair opportunity to strike him on the basis of partiality beforehand.

"[Ameriprise] relies on general allegations about [Summer's] areas of expertise and practice," the judge said. "The case law that Ameriprise attempts to marshal to support its claim calls for a more personal connection than Ameriprise has offered here."

Besides, Woodlock said, Summer's practice "was discoverable by the most basic method of contemporary 'due diligence': a Google search."

The judge did find, however, that the panel had no authority to award Brady attorneys' fees. First, he said, the fact that both parties requested in their respective statements of claim that the other side pay its fees did not — contrary to Brady's argument — constitute a mutual agreement that fees be available, particularly since Ameriprise disputed throughout the proceeding that Brady would be entitled to fees.

Woodlock also noted that the arbitration provision in Brady's employment agreement clearly stated that each side in a dispute would be responsible for their own legal costs unless awarded as part of a statutory remedy. And Chapter 93A, the fee-shifting statute that Brady cited as forming part of her claim, does not apply to employment disputes.

Further, Woodlock said, the panel expressly awarded Brady fees pursuant to G.L.c. 251, §10, which does not give arbitrators such authority.

"In light of the above, I find that the award of attorney fees … may be said to have been made in manifest disregard of the law," he concluded in vacating the award. NEIH

Sharing management communications with auditors

Continued from page 11

whatever it uses to form its financial statement assertions. Management should also be prepared to share more depending on the auditor requests to fulfill its obligations. This question is actually best answered through the transparent and open communication with the auditor.

• When should information be shared with an auditor?

Interestingly, this may be the most important question and the one with the greatest sensitivity, especially noting the omission to share language in the law.

Importantly, there is a balance in the decision when to share sensitive information. Management needs to do its job and have a point of view, with a foundation in Generally Accepted Accounting Principles, on the proper financial reporting treatment for a transaction or event. But management must not delay for so long that it may appear to be withholding information from the auditor.

Once again, open communications allow for discussions with auditors to occur earlier and avoid misperceptions about management intent.

Most important, the management and auditor relationship requires trust to ensure an efficient and thorough audit process, and anything that may raise questions or doubts about the relationship should be addressed timely, and with the assistance and leadership of the audit committee. NEIH

SEC embracing analytics as tool to catch crooked traders

Continued from page 1

the use of data analysis that revealed "suspicious trading patterns" on the part of the defendant.

"We will continue to develop and use data analytics to root out cherry-picking and other frauds," said Joseph G. Sansone, chief of the SEC Enforcement Division's Market Abuse Unit in a statement accompanying the agency's announcement.

One attorney who views the SEC's emerging data analytics capability as a serious regulatory risk for clients is Neil T. Smith.

"They've been using analytics for a while, but they're fine-tuning it now," said the Boston lawyer, who practices in the fields of government investigations, securities enforcement and white-collar defense.

According to Smith, the SEC is moving toward an aggressive data analytics-driven enforcement regime whereby the agency is able to compile and present comprehensive trading analyses demonstrating a potential violation, prior to even opening a formal investigation against an entity.

"They're not shooting first and asking questions later, but they are coming in ready to charge," Smith said. "They're saying, 'We don't believe you can possibly refute the data, so you either settle with us or we're going to charge you.'"

Smith predicted that, as the SEC obtains more favorable outcomes through enhanced analytics, it will become even more inclined to use such tactics.

"Everyone agrees that the [SEC's] use of data analytics is a good thing. But data doesn't always tell the whole story. Any analytics tool may have built-in assumptions that may or may not be valid."

— Ian D. Roffman, securities enforcement lawyer

False positives

Ian D. Roffman, a securities enforcement lawyer in Boston and former senior trial attorney for the SEC, pointed out that the agency uses analytics both to monitor trading activity and examine public company financial statements.

And though securities attorneys view large investment firms as having the resources to deploy their own internal analytics programs to police themselves, lawyers like Roffman are concerned that smaller companies may not have the means to avoid "false positives" when the agency's data analytics trigger a costly SEC investigation.

"Everyone agrees that the [SEC's] use of data analytics is a good thing to the extent that it is able to identify bad actors and remove them from the industry," Roffman said. "But data doesn't always tell the whole story. Any analytics tool may have built-in assumptions that may or may not be valid."

According to Roffman, the SEC needs to be careful it doesn't take advantage of smaller companies by "jumping to conclusions" too quickly. He added that the agency should be sensitive to the costs that data analytics tools impose on "good-faith actors" who want to ensure they're not caught up in the search for bad actors.

"It needs to be open and transparent about its data analytics so that people facing an investigation have a fair opportunity to understand the data the government is looking at and respond to it," Roffman said.

In order not to be swept up in the SEC's net, Roffman said that honest market participants need to have a data analytics component as part of their own internal compliance program. Such a program should allow the company to look at trading patterns in real time in order detect any problems that need to be addressed.

Home-grown program

Analytics came to the fore of enforcement activity early in 2011 with the creation of a detection center in the SEC's Market Abuse Unit. The center is staffed with specialists with trading experience who use technology to analyze "billions of lines" of trading data to investigate and build insider and abusive trading cases.

At a technology summit this past spring, former SEC Chairman Michael S. Piwowar described one of the commission's key technological enforcement tools for detecting insider trading and market manipulation activities.

The Advanced Relational Trading Enforcement Metric Investigation System was developed in-house by commission staff. Piwowar explained that ARTEMIS combines historical trading and account holder data with other data sources "to enable longitudinal, multi-issuer, and multi-trader data analyses."

According to a Reuters report, though the SEC does not have a "direct feed" of market trading data, it has the capacity to mine billions of lines of "Blue Sheet" data of trades executed by brokerages. Blue Sheet data files contain both trading and account holder information and provide the SEC and other regulatory agencies the ability to analyze a firm's trading activity.

Investment firms are required to provide "complete, accurate and timely" Blue Sheet data in response to regulatory requests, allowing regulators to better identify insider trading schemes and other fraudulent activity. The ARTEMIS program analyzes historical patterns and relationships from the Blue Sheet data.

For example, in the insider trading context, ARTEMIS flags traders who exhibit an unusual pattern of making judicious trades in advance of the release of company news that affects stock prices.

"We surveil the trading in the securities markets to identify patterns of suspiciously profitable trading," Sansone told New England In-House.

For example, Sansone said, the SEC in May filed insider trading charges in federal court in New York against investment banker Woojae Jung. The SEC alleged that Jung used sensitive client information in order to trade in the securities of 12 different companies prior to the announcement of "market-moving" events.

The SEC further alleged that the defendant used an account held in the name of a friend living in South Korea to place the illegal trades, which generated profits of approximately $140,000.

"Like others before him, Jung's alleged scheme failed when our data analysis uncovered the account's suspicious trading pattern and, despite Jung's attempts at evasion, traced the trading back to him," Sansone said in an agency statement announcing the charges.

Going after the little guy?

For years, the mining of data has been common in the SEC's prosecution of the big insider trading cases. But New York attorney Meghan K. Spillane said she's detected a recent trend in which smaller traders are also being caught in the agency's net.

"It's not limited to these big players and these big events," said Spillane, who practices securities law and white-collar defense. "The SEC also pursues cases against relatively small, individual traders that make relatively minor profits."

According to Spillane, the SEC's computers and programs have "gotten smart" about the way individual market participants typically trade, allowing the agency to better detect anomalies and an individual's break from his or her normal trading patterns.

"Everyone should be aware that the SEC currently has the tools to look at an individual trader's conduct," she said. "The SEC is not simply being reactive to a big event or a tip; it's acting proactively to detect activity that years ago may have been missed."

According to the government, analytics helped reveal that defendant-broker Bressman allegedly made certain trades, placed them in a holding or "allocation" account, waited for a short period to see how the stocks fared, then "cherry-picked" the profitable trades, which he transferred from the allocation account to his own account or the account of two family members.

Trades that turned out to be unprofitable allegedly tended to land in the accounts of his customers.

Hot spot for enforcement?

With so many financial service companies in Massachusetts, it should come as no surprise that the U.S. District Court here has become a hot spot for SEC enforcement featuring the use of analytics.

In January 2017, the SEC filed fraud charges against Massachusetts-based investment advisor Michael J. Breton and his firm Strategic Capital Management. The SEC alleged Breton defrauded clients out of approximately $1.3 million in another cherry-picking scheme detected by data analysis.

With the announcement of the charges, the agency further announced that Breton had agreed to be banned from the securities industry.

After Breton later pleaded guilty, U.S. District Court Judge Allison D. Burroughs sentenced him to two years in prison and two years of supervised release. The judge further ordered the defendant to forfeit $1,326,696 and to pay restitution in the same amount.

Sansone told New England In-House that cherry-picking cases are a good example of how valuable data analysis can be used as an enforcement tool.

"We can use the analytics to show that a hugely disproportionate number of the profitable trades ended up in the investment advisor's own account, as opposed to his clients' accounts, and to show through statistical analysis that that was not an accident or coincidence," Sansone said.

Data analysis also plays an important role in generating evidence necessary to build a case against a defendant, even when it may not initiate the case, according to Sansone.

He pointed to a case in which U.S. District Court Judge Rya W. Zobel entered final judgment in February, after the defendant agreed to settle with the SEC. In *SEC v. Amell*, the SEC alleged that a Massachusetts-based portfolio manager at an unidentified "major asset management firm" diverted $1.95 million to his personal brokerage account from a fund over which he had trading authority.

According to the government, Kevin J. Amell conducted a "matched-trades" scheme in which he pre-arranged the purchase or sale of call options between his own account and the brokerage accounts of the fund at prices that were disadvantageous to the fund and advantageous to him.

The final judgment required the defendant to disgorge $1.95 million realized from the fraud. The defendant had pleaded guilty in a parallel criminal case in which he was sentenced to 18 months in prison.

Sansone said evidence generated by the SEC's data analysis experts was critical in "marrying" the trading that was done on behalf of the investment firm with the trading that was done in the defendant's individual account to show how he "systematically" benefitted from trading against his clients.

"The power of this evidence helped the government secure a prompt guilty plea and favorable settlement in the SEC case," Sansone said. NEIH

IN-HOUSE WITH …

BRIAN R. ELWORTHY • TOAST

Continued from page 1

perspective. When I joined, there were 300 people and I was the first lawyer at the company. A lot of people weren't sure if they should only go to legal when there was a problem. Now, everyone realizes that legal can actually help them bring to fruition a lot of the ideas that they're working on.

So ensuring that we are providing quick service and good service to our employees while staying on top of everything is one of the first things. And keeping an eye on what's happening right now in terms of regulation for privacy legislation. The trend is moving in a way that probably as a consumer is something I would like, but as a company in the software space it's not necessarily favorable. Seeing where that ends up and what effect it has on software companies like Toast is something that I'm certainly watching.

Q. *What are the biggest regulatory challenges for Toast as the provider of a restaurant management platform?*

A. We're a company that plays in a number of different spaces. We're a SaaS [Software as a Service] company. We have Irish-based employees, so GDPR applies to those employees. On a local level, our product is subject to many local regulations with respect to how the product is working and interfacing with the end-user, the consumer. We're processing payments as well, so we have a myriad of regulations we're subject to in that area; PCI [the Payment Card Industry Data Security Standard] is one of those. It's a pretty regulated space.

Q. *What adjustments did you have to make to comply with GDPR?*

A. Though we have employees based in Ireland, we do not have any European customers yet. It did require putting in place a number of data processing agreements and disclosures with our employees. But right now, because we're not offering our services to the entire EU, we don't yet have to put in place a fully compliant program.

Q. *Has the company's growth created a need to hire more outside counsel?*

A. The workload grows as the company gets bigger, but we continue to be pretty self-reliant and we can do a lot of the work in-house. The frequency of using outside counsel does increase for some types of projects — for instance, financing or putting in place a credit facility. Those are the types of things where you really do use a specialist firm.

Even though work is increasing as the company grows, our internal resources are able to deal with many of the issues, and then we continue to use outside counsel as needed. We use a combination of larger firms — Goodwin and Ropes & Gray — and some smaller regional firms as well.

Q. *Is it challenging to account for the needs of customers ranging from small shops to national chains?*

A. The nice thing is our larger customers, our enterprise customers, have a lot of product requests and feature requests that are unique to them, but those requests actually make our product better for everyone else … because one of our smaller customers may actually need and like those features.

Q. *What do you do to keep up with changes in the law and industry developments?*

A. I'm involved in the local TechGC community in Boston, which is a great resource. It's a national organization now with a very large presence in Boston, New York and San Francisco. Every quarter, there is a dinner focused on a topic that's very germane but also gives you a resource and network of people to reach out to for any recommendations for counsel or questions about issues.

There are a lot of industry websites I'm constantly reading, and I'll read any sort of news on what's affecting our space. The nice thing is that our larger outside firms like Goodwin and Ropes will send us client alerts on areas that are affecting the company, which are helpful.

Q. *What's the work-life balance like for in-house counsel at a startup?*

A. I tell everyone that I work just as hard now as I did when I was an associate at Ropes & Gray. As an associate at a firm, you're constantly living in documents. Here, you're working with people and the business more, and instead of giving a five- or six-page answer on something, you're giving a five-line response in an email to move the process forward. I think I work smarter here than I did when I was at a firm — you're forced to by the nature of how quickly things move. NEIH

With proposed rule, NLRB set to revamp 'joint employer' test

Continued from page 2

"The NLRB almost never engages in rulemaking," he said. "It almost always operates adjudicatively."

Gursky said the board's decision to resort to rulemaking to address the joint-employer issue represents a transparent effort by the majority to make an "end run" around its failed attempt in *Hy-Brand* to overturn *Browning-Ferris*.

He speculated that a lower standard for recusal when the board exercises its rulemaking authority will allow board member Emanuel to vote to approve a final rule, even though apparent conflicts precluded him from participating in *Hy-Brand*.

"My guess is that the real reason they're going through this [rulemaking process] is to overrule *Browning-Ferris* in a way that the disqualified board member could still be a part of it," Gursky said.

The proposed rule is aimed at limiting the board's discretion in future cases, according to Michael J. Yelnosky, dean of Roger Williams University School of Law in Rhode Island.

"By codifying the test in a regulation or rule in this way, what the board is trying to do is make [the standard] as clear as possible and give the board as little wiggle room as possible," Yelnosky said.

He said he expected a final rule to withstand challenges in the courts, though he speculated that Emanuel's conflict issues may provide the strongest legal argument for those who oppose the rule.

"There's a question as to whether a board member who had an ethical conflict that prevented his participation in an adjudication can go ahead and participate in a rulemaking," Yelnosky said. "But because of the nature of rulemaking, I think the answer to that question is 'yes.'"

As for opponents who might plan to argue that the proposed rule is inconsistent with the NLRA, Yelnosky said he saw little hope for success.

"It seems to me that the statute is capable of bearing this interpretation," he said. "As long as they go through the [rulemaking] process correctly, then what emerges at the end should be an enforceable rule."

Though businesses may hope for a reversion to the old joint-employer standard, Gursky pointed out there could be some unintended consequences.

"In addition to screwing over workers, this is also going to screw over small companies who are going to bear the brunt of liability when they are forced into a decision that the general contractor or franchisor makes them make," he said. "They won't be able to share that liability."

But DiGiovanni maintained that liability rightly rests with the entity that actually committed the wrong.

"The way larger companies look at it, if they're not really involved in the day-to-day operation of the terms and conditions [of employment], they don't want to be liable for one of their contractor's misdeeds," he said.

DiGiovanni said he expected the board to adopt a final rule along the lines of the proposed rule, the key being that unions will be required to show that a company actually exercised control over conditions of employment and not just had the potential to do so.

A "codified" joint-employer rule may be less susceptible to the "shifting political tides" of the NLRB, providing needed consistency and predictability to all stakeholders, according to DiGiovanni.

"Unions are going to need to show that an employer or joint employer actually has some skin in the game," he said. NEIH

Foreign company's sales subject it to jurisdiction

Continued from page 1

target the United States with its business, an argument premised on the Supreme Court's 2011 decision in *J. McIntyre Mach., Ltd. v. Nicastro*.

The 24-page decision is *Plixer International, Inc. v. Scrutinizer GmbH.*

Options available

Even though the 1st Circuit took pains to limit its decision to the facts before it, there are lessons to be taken from the ruling, practitioners say.

The plaintiff's attorney, James G. Goggin of Portland, Maine, pointed to the significance the 1st Circuit placed on the defendant's failure to restrict access to its website. Other companies may want to heed the admonition about using geo-blocking software or, at a minimum, put disclaimers on their websites that make clear they are not trying to do business in a particular jurisdiction, he said.

He declined to comment further, citing the ongoing nature of the case.

The defendant's attorneys, Edward J. Sackman of Manchester, New Hampshire, and John A. Woodcock III of Portland, Maine, did not respond to requests for comment.

The issue of jurisdiction in the internet age has been "plaguing courts for a while," said Stacey P. Nakasian of Providence, Rhode Island.

The *Plixer* decision "certainly expands our understanding of jurisdiction" in cases of web-based commerce, even as the court limited its holding to the specific facts before it, she said.

"The key here is to find a federal claim," Nakasian said. "That's what gave traction to the plaintiff."

Future plaintiffs will now look for federal claims, given the *Plixer* precedent, she added.

Boston attorney Joseph M. Cacace said another takeaway is the importance for a plaintiff to take early discovery, if necessary, to establish the quality and quantity of the business the defendant is doing in a particular forum.

Nakasian said it is fairly standard now, at least in the 1st Circuit's federal District Courts, for judges to allow such discovery while being careful not to let the discovery bleed into other issues and make the process cumbersome.

Though the Supreme Court weighing in would be helpful, Cacace said the *Plixer* decision helps define what beyond having an accessible website will subject a defendant to jurisdiction — and the answer is not much.

Here, the sales were "more than de minimis," but not "massive" either, and the German company had no presence in the United States beyond selling its services on the internet, Cacace said.

That the court did not feel bound by the plurality decision in the *Nicastro* case is perhaps unsurprising, given that two of the four members of that plurality, Justices Anthony M. Kennedy and Antonin G. Scalia, are no longer on the Supreme Court, Boston attorney Scott A. Birnbaum said. *Plixer* instructs future defendants that, in the 1st Circuit at least, they will not be able to rely on *Nicastro* to get a case dismissed on jurisdictional grounds.

The law, in terms of jurisdictional jurisprudence, has not yet caught up with the relatively new phenomenon of online sales, he added.

Boston attorney Michael F. Connolly agreed. Ten or 15 years ago, the burden of compelling the defendant to travel to defend itself in a U.S. court and the forum selection clause in its contract might have carried the day, he said.

Catherine I. Rajwani said the defendant also was not helped by the fact that it had filed a Section 1(a) application for registration of the trademark of its name, indicating that it had been using the trademark in the United States for a number of years.

"While maybe that didn't tip the scales, given the U.S. sales, I think that was a very bad fact for them. I was surprised that while there was a litigation ongoing, that that decision would have been made," said Rajwani, who practices in Northborough, Massachusetts.

Nakasian agreed.

"That showed Scrutinizer knew it was doing business here and supported a finding of intent of doing business here," she said.

Rajwani also found it curious that the defendant's total worldwide sales were not part of the record.

"To me, if those [U.S.] sales represented a relatively small portion of their sales — certainly 5 percent or less — I think that that would have really mattered to the court in their overall analysis," she said.

Scrutinizer under scrutiny

Defendant Scrutinizer GmbH1, a German corporation with its principal place of business in Kassel, Germany, runs a "self-service platform" that helps customers build better software.

Although the website is in English, customers who contract to use Scrutinizer's global online service can pay only in euros. The company's standard contract contains forum-selection and choice-of-law clauses that provide that all lawsuits relating to the contract be brought in German courts and under German law.

Scrutinizer maintains no U.S. office, phone number or agent for service of process. It apparently directs no advertising at the United States, and its employees do not go to the United States on business.

Scrutinzer claims on its website to be a partner on over 5,000 projects with companies around the world. Between January 2014 and June 2017, Scrutinizer had served 156 U.S. customers in 30 states, bringing in just under the equivalent of $200,000, according to information provided in discovery.

Two of Scrutinizer's customers hailed from Maine, home base to plaintiff Plixer International, which sued Scrutinizer for allegedly infringing on its U.S. registered mark "Scrutinizer" in federal District Court in Maine on Nov. 21, 2016.

Though Plixer filed for the trademark in July 2015, its application indicated that Plixer began using the mark as early as November 2005 in relation to computer software and hardware used in the field of information technology "for analyzing, reporting and responding to malware infections and application performance problems."

Plixer argued that the identical names and similarities between the products would cause consumer confusion, dilute its rights, and interfere with its use of the mark.

One of the two bases Plixer gave for personal jurisdiction was that Scrutinizer's nationwide contacts with the United States supported specific jurisdiction under Federal Rule of Civil Procedure 4(k)(2).

After rejecting an initial motion to dismiss, the District Court judge allowed limited jurisdictional discovery.

For reasons unclear in the record, Scrutinizer filed a U.S. trademark application for "Scrutinizer" in January 2017.

On prima facie review, U.S. District Court Judge D. Brock Hornby found that the court could constitutionally exercise specific personal jurisdiction over Scrutinizer under Rule 4(k)(2).

As part of his analysis, Hornby found that while Scrutinizer's application for U.S. trademark protection was not conclusive, "it does confirm [Scrutinizer's] desire to deal with the American market."

Given the lack of Supreme Court guidance on the issue, however, Hornby believed an interlocutory appeal was warranted.

The 1st Circuit agreed and granted the appeal.

'Nicastro' under microscope

As for why it did not feel bound to follow the guidance of the plurality of the Supreme Court in *Nicastro*, Lynch explained that, given the fragmented nature of the decision (none of the rationales for the result enjoyed the assent of five justices), the holding "may be viewed as that position taken by those members who concurred in the judgment on the narrowest grounds," citing *Marks v. United States*.

In this particular instance, it led the 1st Circuit to agree with the conclusion of Justice Stephen G. Breyer that "the plurality's seemingly strict no-jurisdiction rule" was unnecessary.

At the other end of the spectrum, Breyer was also critical of New Jersey's test, which would liberally subject a foreign defendant to jurisdiction, if it "knows or reasonably should know that its products are distributed through a nationwide distribution system that might lead to those products being sold in any of the fifty states."

The 1st Circuit said it did not need to adopt such a broad rule to uphold the exercise of specific personal jurisdiction over Scrutinizer.

"Ultimately, although a close call, we conclude that the German company could have 'reasonably anticipated' the exercise of specific personal jurisdiction based on its U.S. contacts," Lynch wrote.

Though the record did not reveal what percentage of Scrutinizer's business came from the United States, it did show that Scrutinizer used its website to obtain nearly $200,000 in U.S. customer contracts over three and a half years.

"This is not a situation where a defendant merely made a website accessible in the forum," Lynch wrote. "Instead, Scrutinizer's voluntary service of the U.S. market and its not insubstantial income from that market show that it could have 'reasonably anticipated' being haled into U.S. court."

The 1st Circuit noted that its holding was consistent with the Supreme Court's opinion in *Keeton v. Hustler Magazine*, post-*Nicastro* rulings from around the country, and decisions from its sister circuits.

The court also stated that it believed it was free to consider Scrutinizer's U.S. trademark application, despite the fact that it was filed after the litigation began.

Ultimately, the 1st Circuit decided it agreed with the District Court judge that the trademark application confirmed Scrutinizer's desire to deal with the U.S. market but did not "tip the scales." NEIH

INVESTING IN THE FUTURE

Day Pitney and the Association of Corporate Counsel's Northeast chapter recently co-presented a program on 'The Power of Women with Wealth' at Day Pitney's Boston office. Nearly 40 attendees, including general counsel from Greater Boston, participated in a conversation about how women are accumulating wealth and, in turn, investing in themselves, each other, their communities and their families. The panel (from left): Glynis Ritchie and Barbara Freedman Wand, of Day Pitney; Nicole Peterkin of Peterkin Financial; and Beth Milkovits of Brown Brothers Harriman