

## Codes of Ethics and Securities Litigation

April 30, 2020

**A \$240 million settlement last month in a federal securities class action against Signet Jewelers Ltd. highlights risks that public companies face in connection with statements in their codes of ethics, codes of conduct, and other similar compliance documents. Public companies should think carefully—and consult where appropriate with disclosure counsel—about their corporate codes of ethics and related documents and disclosures.**

### Securities Litigation Arising from Corporate Codes of Ethics

In the years since Congress enacted the Sarbanes-Oxley Act in 2002, many companies have adopted codes of ethics or codes of conduct and made them public. Item 406 of Regulation S-K specifically contemplates that public companies disclose whether they have adopted “codes of ethics” that apply to senior financial officers that are designed to deter wrongdoing and promote, among other goals, honest and ethical conduct and compliance with applicable governmental laws, rules and regulations. Listed companies are required to adopt and disclose codes of conduct pertaining to directors, officers and employees.

By adopting codes of ethics or codes of conduct and making them public, companies may unwittingly create a new target for class action lawyers seeking to assert claims under the federal securities laws. Although these documents are not necessarily written for a broader audience of investors, because they are widely available public statements, they have the potential to create exposure under federal securities laws if a company’s stock price declines.

In fact, federal securities lawsuits targeting statements about corporate codes of ethics are now common in so-called “event-driven” cases—that is, securities litigations that accompany and arise out of otherwise unrelated legal and compliance issues. Examples include bribery and Foreign Corrupt Practices Act investigations and—more recently—investigations of sexual harassment that have accelerated as part of the #MeToo movement. Although circumstances vary by situation, complaints in this area typically allege that the company’s ethics code falsely represented reporting or compliance standards, or that the company used its code of ethics misleadingly to tout the existence of an ethical culture while omitting to disclose allegedly widespread misconduct.

Historically, these claims rarely gained traction. Courts concluded that statements in codes of ethics were aspirational or inherently vague and immaterial, and hence not actionable under the securities laws. For example, last year, the United States Court of Appeals for the Second Circuit explained in *Singh v. Cigna Corp.* that “general statements about reputation, integrity, and compliance with ethical norms are inactionable ‘puffery,’ meaning that they are too general to cause a reasonable investor to rely upon them,” and that the statements contained in the defendant’s code of ethics “amount to general declarations about the importance of acting lawfully and with integrity, fall[ing] squarely within this category.”<sup>1</sup> Other courts have dismissed similar claims for failing to adequately allege that any statement

---

<sup>1</sup> 918 F.3d 57, 63 (2d Cir. 2019) (internal citation and quotation marks omitted).

in the company's code of ethics was objectively false or misleading.<sup>2</sup> These decisions stem in part from a concern about creating any rule that would “turn all corporate wrongdoing into securities fraud.”<sup>3</sup>

This is not to say that courts have never found codes of ethics to be a potential source of securities law liability.

In rare circumstances, courts have permitted claims based on highly specific, affirmative factual statements in codes of conduct and similar documents about actual concrete actions a company represented that it took as a matter of course.<sup>4</sup> Courts have also, on occasion, permitted claims to proceed relating to a company's statements *about* its own adherence to its code of conduct. For example, one court held that a company's public comments about its code of conduct were actionable where the CEO “stated that the Code of Conduct was not aspirational but was the ‘standards by which we conduct our operations’ and any ‘violations of the Code will not be tolerated.’”<sup>5</sup>

## The *Signet Jewelers* Litigation

On March 26, 2020, Signet Jewelers agreed to settle a securities class action for \$240 million. This lawsuit had alleged that statements in Signet's code of conduct and code of ethics—available publicly on its website and incorporated by reference in its annual reports—were false or misleading.

In the *Signet Jewelers* case, the court allowed claims to proceed based on statements that Signet made employment decisions “solely” on the basis of merit and that it had “confidential and anonymous mechanisms for reporting concerns.”<sup>6</sup> In reaching this decision, the court reasoned that these statements were actionable because they were “directly contravened by allegations in the [complaint].”<sup>7</sup> The court pointed to detailed allegations—based on the record in a separate employment discrimination case—that Signet had conditioned employment decisions on female employees acceding to sexual demands and had retaliated against women who attempted to report the harassment.<sup>8</sup> In a subsequent order, the court concluded that the statements in Signet's codes—in context—could not be disregarded as mere puffery: “Signet's codes of conduct and ethics . . . touted certain values and practices that constitute the *exact opposite* of what the company allegedly valued and practiced.”<sup>9</sup>

The unusual and extreme facts of *Signet Jewelers* likely explain the court's rulings in that case. There is little doubt, however, that securities plaintiffs will seek to leverage those decisions to try to pursue claims in other cases based on more general statements of compliance with ethical codes.<sup>10</sup>

---

<sup>2</sup> See *Fries v. N. Oil & Gas, Inc.*, 285 F. Supp. 3d 706, 717–18 (S.D.N.Y. 2018).

<sup>3</sup> *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, 845 F.3d 1268, 1276 (9th Cir. 2017) (internal citation omitted).

<sup>4</sup> See, e.g., *In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 508–09 (S.D.N.Y. 2009).

<sup>5</sup> *In re CenturyLink Sales Practices & Sec. Litig.*, 403 F. Supp. 3d 712, 728 (D. Minn. 2019).

<sup>6</sup> See *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16-cv-6728, 2018 WL 6167889, at \*17 (S.D.N.Y. Nov. 26, 2018).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16-cv-6728, 2019 WL 2656338, at \*2 (S.D.N.Y. June 20, 2019) (emphasis in original).

<sup>10</sup> While several courts have cited this decision in permitting claims arising from statements contained in codes of ethics to proceed, the disclosures in most of those cases resemble the more concrete and affirmative representations that prior courts have found actionable. See *In re Grupo Televisa Sec. Litig.*, 368 F. Supp. 3d 711, 721–22 (S.D.N.Y. 2019) (code of ethics statements “proclaimed the concrete steps that Televisa was taking to ensure that its executives and employees did not violate the prohibition on bribery”); *In re CenturyLink*, 403 F. Supp. 3d at 728.

Whatever its impact on future cases, *Signet Jewelers* does serve as a reminder that public companies should regularly and carefully review codes of conduct and codes of ethics—including with disclosure counsel—to ensure that they have been drafted carefully to minimize risk of future securities litigation.

---

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

<b>Alan F. Denenberg</b>	+1 650 752 2004	<a href="mailto:alan.denenberg@davispolk.com">alan.denenberg@davispolk.com</a>
<b>Michael S. Flynn</b>	+1 212 450 4766	<a href="mailto:michael.flynn@davispolk.com">michael.flynn@davispolk.com</a>
<b>Joseph A. Hall</b>	+1 212 450 4565	<a href="mailto:joseph.hall@davispolk.com">joseph.hall@davispolk.com</a>
<b>Michael Kaplan</b>	+1 212 450 4111	<a href="mailto:michael.kaplan@davispolk.com">michael.kaplan@davispolk.com</a>
<b>Edmund Polubinski III</b>	+1 212 450 4695	<a href="mailto:edmund.polubinski@davispolk.com">edmund.polubinski@davispolk.com</a>
<b>Byron B. Rooney</b>	+1 212 450 4658	<a href="mailto:byron.rooney@davispolk.com">byron.rooney@davispolk.com</a>
<b>Richard D. Truesdell, Jr.</b>	+1 212 450 4674	<a href="mailto:richard.truesdell@davispolk.com">richard.truesdell@davispolk.com</a>
<b>Ning Chiu</b>	+1 212 450 4908	<a href="mailto:ning.chiu@davispolk.com">ning.chiu@davispolk.com</a>
<b>Alexander Bystryn</b>	+1 212 450 3017	<a href="mailto:alexander.bystryn@davispolk.com">alexander.bystryn@davispolk.com</a>
<b>Jonathan L. Goldsmith</b>	+1 212 450 3671	<a href="mailto:jonathan.goldsmith@davispolk.com">jonathan.goldsmith@davispolk.com</a>