Simpson Thacher

Regulatory and Enforcement Alert

SEC Charges McDonald's and Former CEO in Connection With Disclosures Surrounding CEO's Separation

January 10, 2023

On January 9, 2023, the Securities and Exchange Commission ("SEC") announced charges against McDonald's Corporation ("McDonald's") and Stephen J. Easterbrook, McDonald's former CEO who was terminated without cause in November 2019. The SEC charged McDonald's with including false and misleading disclosures relating to the circumstances of Easterbrook's separation in its proxy statement in violation of Section 14(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 14a-3 promulgated thereunder, and charged Easterbrook with violating the antifraud provisions of the Exchange Act and the Securities Act of 1933 (the "Securities Act"). The SEC also found that Easterbrook caused McDonald's to file reports that contained materially false or misleading information in violation of the Exchange Act, including the Form 8-K disclosing his termination, and Easterbrook was charged with fraud for his role in contributing to the false statements in the Form 8-K. These charges are notable because they may signal the SEC's heightened interest in public disclosures related to mutually-agreed separations between executives and their companies.

Background

According to the SEC's cease-and-desist order, on November 1, 2019, McDonald's exercised its discretion to terminate Easterbrook without cause after conducting an internal investigation and determining that Easterbrook, in violation of McDonald's policy, had a consensual relationship with a former McDonald's employee. The parties entered into a separation agreement that allowed Easterbrook to maintain unvested stock options and certain stock units valued at almost $44 million that he would have forfeited had he been terminated for cause. Upon Easterbrook's departure from the company, he disseminated a letter to company employees, and McDonald's issued a press release and Form 8-K that were filed with the SEC, disclosing that Easterbrook had a relationship with an employee in violation of company policy. On April 9, 2020, McDonald's filed a proxy statement that disclosed Easterbrook was terminated without cause, rather than for cause, but did not disclose the company's exercise of discretion in reaching this determination.

Months later, in July 2020, following a supplemental internal investigation, McDonald's determined that Easterbrook had inappropriate relationships with other McDonald's employees. This discovery contradicted statements Easterbrook made to counsel during the first internal investigation and was inconsistent with statements attributed to Easterbrook in McDonald's public filings. Shortly thereafter, on August 10, 2020, McDonald's sued Easterbrook in the Delaware Court of Chancery. The parties settled the suit in December 2021, with McDonald's agreeing to dismiss the suit in exchange for Easterbrook's payment to the company of compensation he received under the separation agreement.

While the SEC found that McDonald's failed to disclose that it exercised discretion in terminating Easterbrook without cause in violation of Section 14(a), it did not impose a fine or penalty on McDonald's due to McDonald's substantial cooperation in the investigation. This cooperation included McDonald's voluntarily providing information beyond what was required to be produced, briefing the SEC regarding key facts and documents, and making directors and employees promptly available for testimony. The SEC also recognized that McDonald's took affirmative remedial action against Easterbrook in the form of efforts to claw back compensation to recover value for McDonald's shareholders.

The SEC found that Easterbrook violated the antifraud provisions of the Exchange Act and the Securities Act and caused McDonald's to violate the Exchange Act when he failed to disclose his relationships with additional McDonald's employees. The SEC required Easterbrook pay disgorgement and prejudgment interest of approximately $52.5 million, which was deemed satisfied by the compensation Easterbrook repaid to McDonald's in the Delaware Chancery action, and a civil monetary penalty of $400,000, and barred him from serving as an officer or director of most SEC-registered issuers for five years.

Key Takeaways

The SEC's charges demonstrate the SEC's willingness, using enforcement tools, to second-guess judgments and determinations made by companies in situations about whether to characterize a departure as with or without cause. Those sometimes nuanced decisions are the product of various factors, including good faith evaluation of the facts and litigation risk to the company. While the SEC's pursuit of this investigation may have been influenced by Easterbrook's apparent lack of candor in the initial internal investigation, which in turn was incorporated in McDonald's public filings, the case signals that the SEC may now be more willing to scrutinize areas of internal governance and employment decisions at the board level. In the case of senior management, where termination of employment has clear disclosure implications, companies would be well-served to ensure that the parties responsible for preparing the corresponding public disclosures are fully aware of the key facts and judgments underpinning the employment determination—particularly as to the nature of the conduct leading to termination, the form of termination, and compensation-related impacts. They should additionally make appropriate disclosures regarding such separations, including in proxy statements and Forms 8-K, mindful of the possibility that the SEC may effectively pursue them for disclosures that are deemed insufficient.

This matter also demonstrates the importance of the company's cooperation and the SEC's novel decision to prominently highlight efforts to claw back compensation through litigation as a remedial measure warranting lenient treatment. This recognition is analogous to the SEC's recent applications against corporate executives of Section 304 of the Sarbanes-Oxley Act, that statute's compensation clawback provision. Given the SEC's generally aggressive views surrounding clawback of executive compensation, companies in the uncomfortable position of discovering executive misconduct following termination without cause may want to consider various options of recouping lost compensation.

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