GT GreenbergTraurig

GT Insights for Public Companies

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Corporate Governance

The State of Gender Diversity on Boards

It has been a year since State Street Global Advisers announced its stewardship platform to increase the representation of women in leadership positions by commissioning the installation of a bronze statue of a confident "Fearless Girl" in the heart of Wall Street. Over this past year, State Street reached out to 787 public companies in the United States, United Kingdom, and Australia that had no women on their boards through direct engagement, letter writing or its voting decisions. State Street Global Advisors voted against 511 companies for failing to demonstrate progress on board diversity. Of the others, 152 companies added a female board member and another 34 companies committed to adding at least one woman to their board in the near term.

The impact of the Fearless Girl is expanding beyond asset management firms. In early February, BlackRock Inc. posted a new set of proxy voting guidelines that strongly articulate, for the first time, that it expects to see at least two woman directors on every board of its portfolio companies. ISS also updated its Socially Responsible Investing and Catholic Faith-Based policies to provide that it will recommend against incumbent governance committee members and incumbent board members for boards that are not at least thirty percent diverse and include at least one woman and one ethnic minority, respectively. In early January, California Senators Hannah-Beth Jackson and Toni G. Atkins introduced a bill, SB 826,

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which would require a domestic general corporation or foreign corporation that is publicly held with its principal place of business in California to have a minimum number of women on its board of directors. At the moment, it is unknown whether the code provision could be applied against companies incorporated outside of California, and if the proposed quota requirements and associated enforceability through fines are constitutional.

Notices of Exempt Solicitation: A Possible New Direction in Shareholder Proposal Tactics

Recently, John Chevedden, a prolific individual shareholder proponent, filed his first Notice of Exempt Solicitation possibly signaling a new direction in shareholder proposal tactics.

The Exchange Act rules require shareholders who own more than $5 million of a company's securities and who conduct an exempt solicitation of the company's shareholders to file with the SEC all written materials used in the solicitation. In addition, institutional shareholders also file Notices of Exempt Solicitation, which appear on EDGAR as "PX14A6G" filings, typically to respond to a company's statement in opposition to a shareholder proposal included in the proxy statement or to otherwise encourage (but not solicit proxies from) shareholders to vote a specific way on other proposals.

Chevedden's Notice of Exempt Solicitation contained a "shareholder memo" to the company's shareholders, addressing the company's proposal to ratify its existing special meeting threshold. The SEC staff had previously allowed the company to exclude Chevedden's shareholder proposal requesting a lower special meeting threshold from its proxy materials on the grounds that it directly conflicted with the company's proposal. In the shareholder memo, Chevedden criticized the company's proposal, urging a vote against it.

Although Chevedden may not have owned the required amount of securities in the company to file the Notice, the SEC does not restrict shareholders owning less than $5 million of a company's stock from making "voluntary" PX14A6G filings which can be used as a platform to publicize their views on various proposals. These Notices, as with proxy materials filed in a traditional proxy contest, are posted on EDGAR, among a company's other filings.

Now that Chevedden has filed his first Notice, it is possible that we may eventually see more proponents using Notices of Exempt Solicitation in connection with shareholder proposals and shareholder meetings.

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SEC Enforcement

SEC Brings Rule 701 Enforcement Action Concerning Option Grant

On March 12, the SEC brought an action against a private company for issuing employee stock options without a valid exemption from SEC registration requirements. This is the first enforcement action resulting from the SEC's focus on option-granting practices of late-stage private companies.

The SEC alleged that the company failed to satisfy the requirements of Securities Act Rule 701 which provides an exemption for private companies making offers and sales of securities to employees, officers, and directors under written compensatory benefit plans. Rule 701 requires that certain disclosure materials be delivered to employees if the aggregate amount of securities sold during any consecutive 12-month period exceeds $5 million.

Specifically, the SEC alleged that the company granted approximately $13.8 million in employee stock options without making the appropriate Rule 701 disclosures to the employees. The SEC found that the company, despite being aware of the rule, granted options, and allowed employees to exercise those options, without providing the required financial information and disclosures. According to the SEC Order, the company had financial and disclosure information available, but did not want to provide detailed financials to its employees due to confidentiality concerns. In November 2017, the Staff issued a Compliance and Disclosure Interpretation (Securities Act Rules 271.25) stating that companies can use standard electronic safeguards or physical disclosure rooms to protect the confidentiality of issuer disclosures.

The company settled the enforcement action by agreeing to pay a civil money penalty in the amount of $160,000 and to cease and desist from future violations of Sections 5 (a) and 5 (c) of the Securities Act.

Antitrust

FTC Guidance to Help Safeguard Information Sharing in M&A Discussions

On March 20, 2018, the FTC issued guidance aimed at helping companies engaged in acquisition discussions avoid potential antitrust pitfalls associated with the oversharing of information. Target companies routinely share extensive information about their business with potential buyers, which are often competitors, in connection with the buyer's due diligence of the target company and in negotiating a transaction. Some of this information may be competitively sensitive, such as current and projected price information, strategic business plans, future product offerings, and costs of operating the business. If too much of this information is shared between competitors, then, according to the FTC, it could potentially violate the HSR Act. In its guidance, the FTC laid out some procedural steps and safeguards companies can employ to help manage these risks:

- If companies must exchange competitively sensitive information for due diligence and integration planning purposes in connection with a proposed transaction, they should employ "third-party consultants, clean teams, and other safeguards that limit the dissemination and use of that information" within the companies' businesses. Individuals responsible for competitive planning, pricing or strategy should not be part of the clean teams.

- Companies should adhere to the protocols that they employ and identify problematic information sharing practices.
- If antitrust counsel for either company discovers problematic information sharing or coordination of business activities between the companies during the HSR waiting period, counsel should instruct the companies to cease their activities and information sharing. Antitrust counsel should determine the extent of the information exchanged and whether and how the information was used. The FTC advises counsel to inform FTC staff about problematic information sharing before the staff discovers the documents in its investigation of the merger.

The FTC also provided suggestions to providers and recipients of competitively sensitive information regarding how to safeguard that information during a transaction. These include:

- For disclosing parties:
  - share the least amount of information as is necessary to conduct effective due diligence;
  - mask customer identities and consider aggregating competitive information;
  - redact documents and other information to shield information such as customer identities, particularly if bidders are competitors;
  - consider whether the information provided could be pieced together to reveal confidential information;
  - consider prohibiting users from downloading data; and
  - ensure clear and accountable document destruction instructions.
- For receiving parties:
  - ensure that employees who have access to confidential information understand confidentiality and nondisclosure agreements;
  - establish clean teams and utilize third parties to manage the exchange of competitively sensitive information;
  - ensure clean teams have protocols for how to handle competitively sensitive information and use outside counsel to vet clean team members;
  - ensure confidential information intended for the diligence process is not maintained on internally accessible company networks; and
  - reports prepared by consultants or the clean team for business personnel should be blinded and aggregated to safeguard competitively sensitive information.

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Litigation

In Delaware, D&O Insurance Can Provide Coverage for Fraud Claims

In a March 1, 2018 opinion, the Delaware Superior Court's Complex Commercial Litigation Division held that:

- absent a contrary choice-of-law provision in the contract itself, Delaware law governs disputes regarding D&O policies covering Delaware corporations; and
- there is no Delaware public policy that clearly prohibits insurance companies from indemnifying directors or officers of a Delaware corporation for breaches of the duty of loyalty based on fraudulent conduct.

The coverage dispute arose from underlying stockholder litigation in which the Delaware Court of Chancery issued a post-trial opinion finding that certain directors and officers had breached their duty of loyalty through conduct the Vice Chancellor described as fraudulent. The stockholder litigation settled after that opinion issued (before entry of a related implementing order), and the Court of Chancery approved the settlement under applicable standards.

The insurance companies argued in the coverage dispute that California law should apply because the company's principal place of business was located there, but the Superior Court held that Delaware law had the most significant relationship because the insured risk was the directors' and officers' "honesty and fidelity" to a Delaware-incorporated corporation. The Superior Court then rejected the argument that Delaware public policy prohibited indemnification for fraudulent conduct, explaining that Section 145(g) of the Delaware General Corporation Law allows a corporation to purchase and maintain insurance against *any liability* that could be asserted against its directors or officers, even claims that the corporation may not itself have the power to indemnify.

The Court further noted that no "Delaware decision [] holds that a corporation cannot obtain directors and officers liability insurance that covers breach of loyalty based on fraud," and that "although it may strain public policy to allow a director to collect insurance on fraud, it does not appear to be explicitly prohibited by Delaware statutory law." Thus, the Court concluded that Delaware public policy does not clearly prohibit insurance companies from indemnifying breaches of the duty of loyalty based on fraudulent conduct.

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