From Tiny to Growth: A Checklist for Companies

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Agenda

- Board Minutes and Materials: Best Practices
- Attorney-Client Privilege and Work Product Doctrine
- Responding to 220 Demands
- 10b5-1 Trading Plans and Insider Trading Policies
- Regulation FD
- Disclosure Risks in a Down Environment

Topic 1: Board Minutes and Materials

10 Guiding Principles

1. Know the purpose for the minutes
2. Use plain English, but avoid a casual tone
3. Be consistent across all sets of minutes
4. Be careful about describing legal discussions
5. Reference all attachments and exhibits
6. Get speaker or stakeholder approval
7. Close out all open items
8. Establish and document retention policies
9. Identify when speakers and attendees change
10. Be brief, but include the necessary details

Board Minutes: How Detailed Do I Get?

Detail in board minutes is a double-edged sword

- Be brief and concise as possible
- But details can be important to reflect deliberative process, especially for:
  - Risk management
  - M&A
  - Governance concerns

Remember, board minutes are likely the first stop in a 220 demand

- Will they suffice to satisfy a shareholder's proper purpose?

What About Board Materials?

Best Practices

- Be deliberate
- Consider your Board's record of diligence
- Tracking access
- Notes and doodles

Privilege

- Who prepared the materials?
- Were the materials also delivered verbally (and by whom)?
- Who received the materials?

Other Considerations for Board-Level Communications

Board level documents

- Minutes, notes, decks, etc. generated during, or for use during, a meeting

Keep good records

- Adequate minutes, copies of board materials

Areas of concern

- Notetaking
- Substantive board communications over text, email, etc.
  - Texting during meetings
- Board portals

Topic 2: Attorney-Client Privilege

- Attorney-Client Privilege – protects communications between a client and counsel made in connection with seeking or providing legal advice.
- Protects legal advice, not business advice
  - When mixed, "principal purpose" must be legal advice
- Governed by state law, but federal common law governs cases with federal questions
- Controlled by the client, not counsel
- Ethical rules re client confidences broader than privilege
- Cannot be overcome by showing of need
- Crime-fraud exception

Hypotheticals: Attorney-Client Privilege

#1 CFO sends email labeled "privileged" to Board, cc'ing the company's General Counsel, with an update regarding lower-than-expected revenue and earnings for the quarter and identifies reasons for the disappointing results.

Is this email A= Privileged; B=Not Privileged?

#2 Although not requested in the email above, the GC responds with her thoughts on whether the company is legally required to disclose the bad news before the company's regularly scheduled quarterly earnings call.

Is the GC's response A= Privileged; B=Not Privileged?

Attorney-Client Privilege: Common Questions

- Transmittal letters
- Draft contracts, SEC filings and marginalia on same
- Board materials (with attorney present)
- Audit letters
- Insurance carrier correspondence
- Communications with governmental agencies
- Retention letters
- Bills

Work Product

- Work-Product Doctrine shields an attorney's mental impressions, opinions and legal conclusions from discovery
- Based on the notion that the adversarial system cannot function properly unless an attorney is given a zone of privacy within which to prepare the client's case and plan strategy
- Only extends to the document or statement at issue, not to underlying facts
- An adversary may obtain fact work product if it can demonstrate "substantial need" and that it is otherwise unable to obtain the substantial equivalent without "undue hardship." FRCP 26(b)(3).
- An adversary may obtain opinion work product in rare and extraordinary circumstances—e.g., if counsel's mental impressions are at issue and there is a compelling need for disclosure.

Hypotheticals: Work Product Doctrine

#1 Interview Memorandum

In connection with the defense of litigation, outside litigation counsel interviews a key former employee, takes detailed notes and drafts an interview memorandum containing both the information communicated by the former employee and counsel's opinions about that information.

Two-weeks later the former employee tragically chokes to death on a hot dog at a 49ers game while cheering for the Cardinals.

Opposing counsel now seeks to compel the production of the notes and the memorandum.

Can opposing counsel obtain the notes and memorandum? A= Yes; B=No

Hypotheticals, cont'd.

#2 Company Wants to Waive

Same facts as hypothetical #1 but opposing counsel has not asked for the notes or memorandum. Instead, the company wants to waive the work-product protections and provide the memorandum to various constituencies, including the government.

Can the company waive and produce the memo? A= Yes; B= No

Protecting Privilege

Put “privileged” in subject line of emails

- If it actually contains a privileged communication
- Think about the privilege log

Train key executives and members of management

- Meeting invitations
- Forwarding of privileged emails

Don’t combine legal and business in the same message, if possible

Ask outsiders to leave the meeting

- “Who is on this call?”
- Beware of “reply all”

Declare a joint-defense or common-interest privilege

Waiving the Privilege

Company can inadvertently waive through disclosure

- Outside auditors
- Investment bankers

Company can decide to waive

- New management or ownership may have different motivations
- Assertion of reliance on counsel defense
- Desire to cooperate with state or federal regulators

Waiver of Privilege: Ryan v. Gifford

Delaware Court of Chancery held that a company and its special committee had waived the privilege attached to a special committee report by disclosing it to the directors whose conduct the special committee had investigated.

The Court found that the interests of the special committee and the defendant directors were "adversarial" in nature and concluded that the presence of the directors' attorneys showed they were not attending in their capacity as directors

An Exception to Privilege: Garner Doctrine

Garner Doctrine – *Garner v. Wolfinbarger*, 430 F.3d 1093 (5th Cir. 1970) – created exception to privilege where breach of fiduciary duty was alleged

Factors:

- Ownership % of stockholders making demand or claim
- Bona fides of stockholders
- Necessity or desirability of information related to stated purpose
- Is the claim colorable?
- Is the alleged wrongdoing illegal or criminal

Topic 3: Responding to 220 Demands

Under DGCL Section 220, a stockholder may access corporate books and records for a "proper purpose"

- The purpose must be related to their status as a stockholder, for example:
  - To value their interest in the corporation
  - To advocate for a change of management
  - To investigate wrongdoing, provided there is a credible basis
- "Credible basis" is a low standard
  - Stockholder need not disclose their "ultimate objective" in seeking the records (*Woods v. Sahara* (Del. Ch. 2020) and *Lebanon Cty. v. AmerisourceBergen* (Del. Ch. 2020))

Responding to 220 Demands, cont'd.

- 220 inspection requests are often a precursor to litigation
- Stockholders are to use the "tools at hand" to investigate their claims prior to filing derivative lawsuits, or other types of claims
- 220 inspection demands may also be used to object or intervene in related pending litigation

Responding to 220 Demands, cont'd.

Respond within five business days from service of demand

- Can usually negotiate a reasonable timeline for substantive response

Verify stockholder status and compliance with other statutory requirements

- Some written proof of beneficial ownership is required
- Demand should be made under oath, or if made by counsel, it must be accompanied by a power of attorney

Evaluate the "proper purpose"

- A "credible basis" for investigating wrongdoing can be shown through "documents, logic, testimony, or otherwise."
- "Lowest possible burden of proof"; demonstration of "actionable wrongdoing" not required

If you agree to produce documents, enter into a confidentiality agreement

- May limit the purposes for which the materials can be used
- Consider requirements for filing under seal

If company refuses the inspection request, the stockholder may file a lawsuit in the Court of Chancery to compel production of the requested materials

Hypothetical: 220 Demand

The company receives a letter from a purported stockholder, demanding books and records. The stockholder's stated purpose is to investigate potential mismanagement because of the existence of a recently-announced SEC subpoena.

The company writes immediately and offers to provide all board minutes and materials for the period covered by the subpoena.

Is the company's response proper? A=Yes; B=No

Responding to a 220 Demand, cont'd.

Scope of production

Not as wide as civil discovery: "necessary and essential" to the proper purpose

Balancing test: burden on the corporation vs. relevance to stockholder's purpose

What materials are subject to production?

- Formal board materials and board decks
  - Failure to keep relevant board materials may itself give rise to suspicion of breach of fiduciary duty (Woods)
- Increasingly, emails and electronic communications are also within the scope of production
  - "Informal board materials" can include communications between directors and officers and senior employees
  - Can include emails sent on non-corporate accounts
  - Can include "officer-only" level communications
- If a plaintiff provides evidence of wide-ranging mismanagement, more wide-ranging production may be required

How and When to Fight a 220 Demand

Defenses

- Asserted purpose is pretext for an improper primary purpose
- Investigation of mismanagement could not lead to any actionable claims
  - Courts are reluctant to evaluate the merits of defenses to potential plenary litigation when assessing the existence of a proper purpose
  - Not, by itself, a defense that defeats inspection request

Scope

- Highly fact dependent.
- When investigating mismanagement, board materials (e.g., minutes, decks) are almost always going to be produced
  - Often, they are the ending point as well
- Produce undisputed documents before litigation
  - Contextualize discussions about whether additional materials necessary and sufficient
- Discovery into the locations and availability of information sought

How and When to Fight a 220 Demand, cont'd.

Risks

- Corporations sometimes raise aggressive defenses, refusing to produce anything in response to facially valid demands
  - *Pettry v. Gilead Sciences, Inc.*, C.A. No. 2020-0132-KSJM, at 67 (Del. Ch. Nov. 24, 2020)
    - The corporation raised numerous defenses, refusing to produce anything.
    - The Court found the stockholders had a proper purpose, each of the corporation's defenses without merit
    - Invited stockholders to file a motion to shift fees, which was later granted in full
- Poisoning the well for plenary litigation

How and When to Fight a 220 Demand, cont'd.

Non-Disclosure Agreement

- Standard, and almost universally the stockholder agrees to be bound by an NDA in connection with any production
- If the parties do not agree, Court of Chancery can, and often does, condition production on an NDA
- But no presumption in favor of an NDA. Corporation has the burden to prove the need for confidentiality protections, which will be weighed against the stockholder's interests.
  - Books and records "inspections are not subject to a presumption of confidentiality. . . . [T]he Court of Chancery should weigh the stockholder's legitimate interests in free communication against the corporation's legitimate interests in confidentiality." *Tiger v. Boast Apparel, Inc.*, 214 A.3d 933, 935 (Del. 2019).
- If the parties agree on scope, can have a Section 220 action only about the imposition of an NDA or its terms

Topic 4: Insider Trading

Insider Trading

It is illegal to trade a public company's stock if you possess material non-public information

Tipping

It is illegal to pass material non-public information on to others that they then trade upon

What is Material Non-Public Information?

Positive or negative information not available to public that an investor would consider important in deciding whether to buy or sell

Who is an Insider?

- Directors
- Officers
- Employees
- Any others who have access to material non-public information

Insider Trading, cont'd.

The SEC and the stock exchanges have sophisticated detection systems

Insider trading encompasses

- Trading by an insider while in possession of MNPI
- Trading by a non-insider while in possession of MNPI, where the information was disclosed in violation of a duty of confidentiality or it was misappropriated
- Communicating MNPIs to other (tipping)

In a securities class action, plaintiffs argue that suspicious trading by insiders proves a fraudulent motive

- Sales of large percentage of vested shares/options
  - No prior pattern of sales
  - Large sales just before bad news

Examples of Potential MNPI

- Financial results and forecasts
- Confirming or updating previous disclosures or analysts reports
- Significant acquisitions, dispositions, partnerships and collaborations
- Significant new agreements and financial obligations, or termination of significant contracts
- Announcements related to product candidates and discovery programs
- Significant developments in research and development or related to intellectual property
- Changes in senior management or independent auditors
- Pending public or private sales of securities
- Similar information about vendors, suppliers, manufacturers and others
- Significant legal or regulatory developments or threats
- Certain clinical trial results and significant FDA communications
- Suspension of trial, or complete or partial clinical hold
- Information regarding litigation or settlements

Insider Trading Policy

The insider trading policy should prohibit trading while aware of MNPI

- It's not a defense that you didn't "use" MNPI when deciding to trade
- Applies to trading and tipping
- Applies to directors, officers, employees, members of the immediate family/household, economic dependents, and others

Blackout periods

- Quarterly blackout periods
- Special blackout periods may be imposed from time to time

Pre-clearance procedures

- Directors, officers and all other employees, consultants, contractors, agents or other service providers may be required to obtain pre-clearance of a trade from a compliance officer

Exceptions for 10b5-1 Trading Plans

Rule 10b5-1 Trading Plans

- The SEC has created a special rule, Rule 10b5-1, for stock trading plans
- Rule 10b5-1 creates an affirmative defense to insider trading liability if:
  - Trades were made pursuant to a pre-established stock trading plan
  - And the plan was adopted when the insider was not aware of material non-public information
- An affirmative defense is not immunity
- A properly adopted plan may permit trades to occur even when the window is closed or the individual knows of material non-public information
- Anyone in the company can adopt a plan – it is a personal plan, not the company's plan, but the company must approve the plan
- The plan must still comply with Rule 144 volume limitations (if not freely tradeable) and short swing profit rules and Section 16 filings
- The plan should have automatic, formulaic trading rules that specify number of shares and price
- A plan that is amended often is far less likely to offer protection
- The SEC has proposed changes to the rules governing 10b5-1 trading plans
  - More disclosure
  - Less flexibility to amend/modify plans

Topic 5: Reg FD

- FD stands for “Fair Disclosure”
- The goal of Regulation FD is to ensure a “level playing field” of information for all investors by prohibiting selective disclosure of material information
- Regulation FD requires that whenever:
  - a company, or person acting on its behalf,
  - discloses material, non-public information
  - to certain people outside of the company

  then the company must make public disclosure of that information:
  - simultaneously (for intentional disclosures), or
  - promptly within 24 hours (for non-intentional disclosures)
- Regulation FD applies to all material news, including good news, bad news or confirmatory news
- SEC will go after individuals, not just the companies they work for
- Practical effect is that companies need to make sure *when* they share new material information, they do so *publicly* and *broadly*

Reg FD cont'd

- Covers any disclosures made by company or person acting on its behalf, including
  - Any senior official of the company (directors, executive officers, IR/PR personnel)
  - Any other officer, employee or agent of the company who regularly communicates with securities market professionals or stockholders
- Regulation FD applies in particular to statements made to: (i) anyone on Wall Street (broker-dealers, investment advisers, investment companies and hedge funds), (ii) anyone in the financial community, (iii) stockholders and (iv) anyone else who might buy or sell your stock, such as analysts or other market professionals.
- Regulation FD does not apply to statements made to: (i) company employees, (ii) a person who owes a duty of trust of confidence (e.g., attorney, accountant), (iii) customers, suppliers and business partners in the ordinary course of conducting business and others who expressly agree to maintain information in confidence and (iv) the press

Reg FD Guidelines

Correct mistakes quickly, do not compound them

Beware of

- Talking about guidance (e.g., current quarter or year)
- One-on-one meetings
- Follow-up calls to make sure they "get it"
- Non-webcast conferences

Regulation FD does not create a duty to give guidance/updates, but any guidance/updates must be provided transparently and simultaneously via press release or open conference call

- Do not go beyond publicly disclosed information in one-on-one conversations with market professionals or investors or at industry conferences
- Do not suggest changes in company performance or guidance through nonverbal communications

Company website

- Monitor website postings for consistency with other corporate disclosures
- Archive outdated information on the website

Good faith/reliance on advice of legal counsel is a defense if prerequisites are met

Topic 6: Disclosure and Litigation Risks in a Down Environment

- Disclosure obligations more complicated than ever
- Is your company really different from the industry?
- Class action lawsuits a real concern if there is a significant stock drop
- SEC enforcement program
  - It's raining whistleblowers: recent focus on investigations of whistleblower cases even after company investigation
  - Often driven by press and stockholder focus
  - Still particularly interested in traditional areas: accounting, disclosure of events and contingencies, insider trading and insider compensation
  - Increased Foreign Corrupt Practices Act and other anti-bribery law enforcement
- Activist stockholders focused on corporate governance becomes issue later when stock is more widely held
- Derivative litigation: Delaware courts increasingly friendly to derivative litigation and demands for documents