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Board Confidentiality and Communications

Recent developments in Delaware case law highlight the importance for companies of periodically reviewing and updating their corporate governance policies and procedures to protect confidential corporate information provided to directors, as well as board communications and deliberations, from both intentional and inadvertent disclosure outside the company. Practical Law asked *Jennifer T. Wisinski* of *Haynes and Boone, LLP* for guidance on adopting and updating corporate governance policies that address board confidentiality and communications.

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Why is it important to address director confidentiality and communications in a company's corporate governance policies?

A confidentiality policy specifically applicable to directors (board confidentiality policy) serves to inform and remind directors of the importance of confidentiality. A board confidentiality policy is important because most general confidentiality policies define "confidential information" to include "material, non-public information."

However, this definition does not necessarily cover all information provided to directors, board deliberations, or communications between and among directors and the company. In addition, the scope and parameters of a director's duty of confidentiality are not well defined under Delaware law. Maintaining the confidentiality of this information is critical not only to protect the company from competitive or other harm, but also to protect the integrity of the boardroom and board process.

As the Delaware Chancery Court noted in *Disney v. Walt Disney Co.*, when considering whether to permit the disclosure of board communications relating to executive compensation matters in response to a stockholder demand under Section 220 of the Delaware General Corporation Law (DGCL), a potential harm of disclosure is the chilling effect on board deliberations that likely would result "[i]f any shareholder can make public the preliminary discussions, opinions, and assessments of board members and other high-ranking employees." The court also observed that the "preliminary deliberations of a corporate board of directors generally are non-public and should enjoy 'a reasonable expectation that they [will] remain private.'" (2005 WL 1538336, at *4 (Del. Ch. June 20, 2005)).

In this case, the court found that the board communications were confidential and that the potential harm of disclosure outweighed the potential benefits (allowing the stockholder to monitor how the board was performing its duties and the impact of executive compensation on the value of the stockholder's investment in the company). In so holding, the court gave significant deference to the company's confidentiality policy that prohibited present and former directors from disclosing information acquired through their service on the board, including non-public information about board discussions and deliberations.

Specific risks to consider with respect to board confidentiality and communications include:

- **Intentional leaks.** While infrequent, there have been several very well-publicized intentional leaks by directors of confidential board information, including at Hewlett-Packard (see Wall Street J., H-P Board Clash Over Leaks Triggers Angry Resignation (Sept. 6, 2006), available at *wsj.com*), J.C. Penney (see Reuters, Ackman Quits J.C. Penney Board, Removing Distraction (Aug. 13, 2013), available at *reuters.com*), and General Motors (see Wall Street J., GM Accuses Former Board Member of Leaking Confidential Information to Rival Auto Maker (Sept. 15, 2020), available at *wsj.com*). This type of leak can be extremely damaging to the company and its directors. It can also put at risk the ability of a board to have candid, robust discussions and function effectively.
- **Disclosure by constituent directors.** With the rise in stockholder activism over the last couple of decades, companies should consider the risk of allowing a constituent director (so called because of their connection with stockholders, frequently stockholder activists, that nominated or elected them to the board) to share information obtained through service on the board with their stockholder affiliate.
- **Cybersecurity.** With current technology, it is easy to share large amounts of information quickly, as well as view information almost anywhere. Companies should be thoughtful about how board materials are shared with directors, as well as how directors view and use this information given the increased risk of inadvertent disclosure through cybersecurity breaches.
- **Personal devices and accounts.** Many conversations that previously may have occurred in person or over the telephone now occur through texting or other means by which the conversation is recorded and may later be required to be produced in litigation or an inspection demand. Directors should be counseled on the risks of conducting company business through personal devices or accounts, especially with respect to more informal communications, such as texts. Companies and directors should also consider whether the method of communication could result in an inadvertent waiver of the attorney-client privilege.
- **Securities law violations.** When a director speaks to third parties about company business, there is a risk of a violation of Regulation FD or insider trading laws, as well as a risk of contradictory or inconsistent statements that may be problematic for the company. Company policies can mitigate these risks by establishing protocols for these disclosures, if permitted.

What is a director's legal obligation to maintain confidentiality under Delaware law?

Directors have a general duty to maintain the confidentiality of information obtained through their service on the board (see Am. Bar Ass'n, Bus. Law Section, Corporate Director's Guidebook, 75 Bus. Law. 2741, 2766 (7th ed. 2020)). This duty emanates from the duty of loyalty. Notably, a director's confidentiality obligation is not set forth in the DGCL, and relevant Delaware case law is sparse.

Delaware courts have held that directors violate their fiduciary duty of loyalty by, among other acts, improperly using confidential information belonging to the company, without authorization from the board, to advance their personal interests and not those of the company. For example, in *Hollinger International Inc. v. Black*, when the company was considering strategic alternatives, including a corporate restructuring, one of its directors (who was also a controlling stockholder) used confidential information learned through the board's strategic review process to negotiate a secret deal with a third party to sell the equity in his holding company, which owned 30.1% of the company, thwarting the company's efforts to complete its proposed restructuring (844 A.2d 1022, 1061-62 (Del. Ch. 2004)).

Delaware case law does not, however, address in depth the scope of the duty of confidentiality, including the types of information that are considered to be confidential.

Search Fiduciary Duties of the Board of Directors for more on board fiduciary duties, including the duty of loyalty.

What remedies does a company have if a director intentionally leaks confidential information?

Preventing the disclosure of confidential information by directors is important because following an intentional leak, the company's remedies are limited.

Under Delaware law, directors cannot remove other directors (only stockholders can remove directors (DGCL § 141(k))). The board may ask for the director's resignation, but cannot force a director to resign. A company may also consider obtaining an advance resignation from each director, but it is not clear under Delaware law if this type of advance resignation is irrevocable. For example, under Section 141(b) of the DGCL, the only advance director resignation that is expressly permitted to be irrevocable is an advance resignation that is conditioned on the director's failure to receive a specified reelection vote.

In rare cases, a company has sued a director for a confidentiality breach. For example, in 2020, General Motors sued a former director, alleging that he had violated his fiduciary duties when he leaked confidential information learned while serving on the board of a competitor. This litigation is presently ongoing following the recent denial of a motion to dismiss by the US District Court for the District of New Jersey (see *Gen. Motors LLC v. Ashton*, 2021 WL 2549498 (D.N.J. June 22, 2021)).

Ultimately, the board's only remedy may be to wait until the next director election when it can refuse to re-nominate the director, but this may take months (or years, in the case of a staggered board).

If and when a leak occurs, or preferably before a leak occurs, the best path may be to focus on preventing future leaks by:

- Adopting or updating a board confidentiality policy.
- Discussing with board members the critical importance of confidentiality and the damage that can occur with leaks.
- Ensuring that directors are able to express differing viewpoints in board deliberations, which can mitigate the risk of leaks by those who feel they are not being heard in the boardroom.

What should companies consider when adopting or updating a board confidentiality policy?

Key issues a company should consider in adopting or updating a board confidentiality policy include:

- **Defining confidential information broadly.** The definition of confidential information should be broad and cover all non-public information that the director learns through their service on the board, including non-public financial and business operations information, trade secrets, non-public information concerning customers, suppliers, or possible transactions, as well as proceedings and deliberations of the board and its committees. Notably, while most insider trading and Regulation FD policies restrict the disclosure of material, non-public information, they do not typically cover board proceedings or deliberations.
- **Restricting disclosure and use of confidential information.** The policy should include not only a restriction on disclosure to third parties of confidential information, but also a limitation on the use of this information to ensure that each director uses the confidential information solely for advancing the best interests of the company.
- **Addressing disclosure by constituent directors to stockholder affiliates.** The policy may prohibit or limit the ability of a constituent director to disclose confidential information to any stockholder affiliates. Some companies expressly prohibit a constituent director from disclosing any confidential information to their stockholder affiliates, while others permit disclosure as long as the stockholder affiliate itself is subject to a confidentiality obligation. Even if disclosure is permitted, the company can reserve the right to limit disclosure it believes is not in its best interests.
- **Permitting disclosure only through narrow exceptions.** The policy should permit disclosure only in narrow circumstances, such as when required by law (and then with reasonable advance prior notice to the company) or when authorized by the entire board.
- **Reminding directors of their fiduciary duties.** The policy may include a reminder of the board's basic fiduciary duties, including that directors cannot use company information for their personal benefit or in a manner adverse to the company.
- **Defining directors to include current and former directors.** The policy should apply to both current and former directors.

A company may also consider:

- **Advance notice bylaw requirements.** A company's advance notice bylaws can include requirements that a stockholder's nominee for director must agree to certain confidentiality provisions prior to being an eligible nominee. This is frequently accomplished through advance notice bylaws that require stockholder nominees, as a condition to nomination, to represent and agree to adhere to the company's policies and guidelines applicable to directors. (For more information, search Public Company By-Laws (Delaware Corporation) on Practical Law.)

- **A director qualification bylaw provision.** A company's bylaws can include a provision that renders a director who violates the board confidentiality policy ineligible for re-nomination (although there may be limits to the enforceability of this provision).
- **Confidentiality agreements.** A company can require its directors to sign a confidentiality agreement (although this is not common in practice).
- **Frequent reminders.** A company can remind directors periodically of their confidentiality obligations.
- **A crisis management plan.** A company can create a crisis management plan for handling director leaks.

A company should regularly review its board confidentiality policy, especially when changes in board composition or law occur.

Why should a board confidentiality policy address the ability of a constituent director to disclose information to their stockholder affiliate?

Delaware law generally permits a constituent director to pass information to their stockholder affiliate. As the Delaware Chancery Court has noted, "[w]hen a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director" (*Kalisman v. Friedman*, 2013 WL 1668205, at *6 (Del. Ch. Apr. 17, 2013)).

As more and more activists and other stockholders have a director representative on the board, companies should consider the implications of the activist or other stockholder having access to all information provided to the board, as well as board deliberations. Relevant considerations include:

- What type of information is at issue.
- Whether the company or board expects the information to be shared.
- Whether the sharing of the information will harm the company.
- Whether the stockholder has an interest adverse to the company.

To protect the company, stockholder, and constituent director, the company and stockholder can enter into a confidentiality agreement governing if, when, and how information may be shared. (See Corporate Director's Guidebook, 75 Bus. Law. at 2766.)

In addition, a company's board confidentiality policy may address the ability of constituent directors to share information with stockholder affiliates. For example, the policy may expressly prohibit the director from disclosing any confidential information (which should include all information the director learns through their service on the board, as well as board deliberations) to the stockholder affiliate.

Alternatively, it may allow the director to share information with the stockholder affiliate as long as the stockholder signs a confidentiality agreement to prevent disclosure to third parties, as well as to limit the use of the information to evaluating its investment in the company. Even if information sharing is generally permitted, the policy can include an express limitation to restrict disclosure if the company determines that disclosure is not in its best interests.

Search Dealing with Activist Directors on the Board for more on dealing with constituent directors.

In addition to confidentiality, why is it important to consider how board materials are distributed and managed, as well as how directors communicate with each other and the company?

Corporate policies (whether formal or informal) that address how board materials are distributed and managed, as well as how directors communicate with each other and the company, are important to minimize the risk of inadvertent leaks. In addition, they may help protect against inadvertently waiving the attorney-client privilege in the litigation context.

Currently, we communicate through a multitude of technologies and platforms. Given the increased threat of cybersecurity incidents, companies should consider the security of the platforms used to distribute and view board materials, as well as the platforms used by directors to communicate with the company and other directors. In addition, when directors communicate more informally (through texting, for example), there is a greater risk that communications could be taken out of context and viewed differently than intended.

What are the implications of recent litigation on director communications?

Historically, a company may not have considered the implications of a director using a non-company email account to communicate with the company, which may be common when a director also serves as an officer of another company. Following *In re WeWork Litigation*, it is important to manage which email accounts a director uses for company communications to help protect attorney-client privileged communications in litigation.

In *WeWork*, The We Company (WeWork) sought to compel production of certain emails from SoftBank Group Corp. The Delaware Chancery Court held that the attorney-client privilege was waived with respect to emails between SoftBank's counsel and certain SoftBank officers in large part because the officers had sent the emails relating to SoftBank business from their work email accounts at another company (Sprint, Inc.). In so holding, the court analyzed a four-factor test set forth in another case involving a dispute between an employee and his employer where the employer had argued that the attorney-client privilege was waived through the use of work email accounts for non-work purposes. The factors included whether:

- The company maintained a policy banning personal or other objectionable use of work email accounts.
- The company monitored the use of the employee's computer or email.
- Third parties had a right to access the computer or emails.
- The company notified the employee, or the employee was aware, of the use and monitoring policies.

(2020 WL 7624636, at *2 (Del. Ch. Dec. 22, 2020) (citing *In re Asia Global Crossing, Ltd.*, 2005 WL 646842 (Bankr. S.D.N.Y. Mar. 21, 2005)).)

The *WeWork* court found that the factors favored production of the emails even though the Sprint code of conduct did not ban the use of company email for non-Sprint purposes. The court reached this conclusion because the Sprint code of conduct stated that "employees should have no expectation of privacy" in emails sent, received, or stored on Sprint's email server and the code permitted email monitoring.

Should companies limit a director's ability to use cell phones or other devices to conduct company business?

Companies should, at a minimum, counsel directors regarding the implications of using cell phones and other devices to conduct company business. Directors should understand that if they conduct company business through texting on a cell phone or emailing through a personal or company email account, these devices or accounts may be required to be produced in a books and records inspection demand under Section 220 of the DGCL or other litigation. As a result, directors should exercise caution in communicating about sensitive issues through texts or emails because these communications are recorded and are often more informal in nature and could be taken out of context. Depending on the device used, there could also be an increased risk of a cybersecurity breach that results in the inadvertent disclosure of the communications.

In the context of an inspection demand under Section 220 of the DGCL, Delaware courts have both granted and denied access to personal email accounts and devices of directors. In *Schnatter v. Papa John's International, Inc.*, the Delaware Chancery Court held that if a director used personal accounts and devices to communicate about company business, the director should expect that information communicated through the devices, including emails and text messages, may be subject to production in an inspection demand. The court noted, however, that it did not mean to suggest any bright-line rule and that judicial discretion should be applied "on a case-by-case basis to balance the need for the information sought against the burdens of production and the availability of the information from other sources." (2019 WL 194634, at *16 (Del. Ch. Jan. 15, 2019), *abrogated on other grounds by Tiger v. Boast Apparel, Inc.*, 214 A.3d 933 (Del. 2019).)

Moreover, following the Delaware Supreme Court's decision in *KT4 Partners LLC v. Palantir Technologies Inc.*, companies should counsel directors that communications on phones or devices (whether personal or company-issued) may be subject to production if it appears that the directors are conducting company business through these communications. The court noted that, "[u]ltimately, if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters, it will likely be able to satisfy a § 220 petitioner's needs solely by producing those books and records. But if a company instead decides to conduct formal corporate business largely through informal electronic communications, it cannot use its own choice of medium to keep shareholders in the dark about the substantive information to which § 220 entitles them" (203 A.3d 738, 742 (Del. 2019)).

What policies or procedures should companies consider to manage the information in board materials and director communications?

A company may:

- **Distribute board materials through a board portal.** The company may use a secure board portal for the distribution of board materials, as well as communications between directors and the company. With a board portal, a company can electronically and securely deliver all board materials immediately to each director. Directors can easily access all materials without having to carry paper documents with them. Companies should consider providing directors with the technology needed to view board materials to avoid them accessing, viewing, and saving information on personal devices.
- **Designate approved communication methods for directors.** At a minimum, outside directors should not use email accounts of other companies to conduct

company business because of the attorney-client privilege waiver risk. Instead, the company should:

- issue company email accounts for directors to use for internal communications, or have directors communicate through a confidential board portal; and
- require directors to use only password-protected electronic devices for accessing company information.

- **Establish guidelines for printing and saving board materials.** The company should consider:
  - limiting the ability of directors to print board information;
  - requiring that company data be stored only on company-provided devices; and
  - prohibiting directors from saving board information to personal computers or other electronic devices.
- **Destroy copies of printed materials and notes following a board meeting.** Any director copies of printed materials used in a board meeting, as well as any director notes, should be destroyed at the conclusion of the meeting, so that the only written record is the minutes taken by the secretary of the meeting and approved by the board. If directors can make notes on materials in an electronic board portal, those notes should also be removed at the conclusion of the board meeting.
- **Periodically review retention policies.** The company should consider how long it will maintain certain communications with directors, including board self-evaluations that may contain sensitive information.
- **Require directors to give notice of potential leaks.** Directors should immediately report any stolen devices or cybersecurity incidents to the company.

Why is it important to address director communications with parties outside the company in corporate governance policies?

Corporate governance policies and procedures regarding director communications with investors and other third parties help a company manage the content and timing of disclosure and ensure that the company speaks with one voice. In addition, these policies help mitigate the risk of violating the securities laws, including insider trading laws and Regulation FD. Virtually all public companies have an insider trading policy that restricts trading on the basis of material, non-public information, as well as tipping. However, companies should consider whether to also adopt a Regulation FD policy as to whether a director may speak to third parties about the company, or include these provisions in its corporate governance policy.

Search Regulation FD Policy and Corporate Policy on Insider Trading for model Regulation FD and insider trading policies that apply to all employees and directors, with explanatory notes and drafting tips.

Search Regulation FD Training for Public Companies: Presentation Materials for a PowerPoint presentation that counsel can use to train a company's executives and other employees about their obligations under Regulation FD.

What are some best practices to address external communications by directors?

Consistent with SEC guidance (see SEC Compliance and Disclosure Interpretations, Regulation FD, Question 101.11), specific practices that companies can implement regarding director communications with third parties include:

- **Restricting directors from talking about the company with third parties.** A policy may provide that the CEO or management speaks for the company, and directors are not authorized to speak on behalf of the company absent express authorization from a designated person, such as the chair of either the board or the nominating and corporate governance committee.
- **Requiring central coordination of external communications.** All external communications should be centrally coordinated to maintain consistency in substance, as well as ensure that procedural safeguards are followed.
- **Referring all media inquiries to a designated person or group.** All media inquiries should be referred to a designated person or group, and directors should not speak to the media on behalf of the company.
- **Specifying procedures for approved communications.** To the extent that a director is permitted to speak with third parties, the company should consider:
  - having talking points cleared by a designated company officer;
  - having a second company representative present; and
  - requesting the recipient to sign a confidentiality agreement. PL