TheCorporateCounsel.net

"Director Independence: Recurring Issues and Recent Developments"

Wednesday, March 5, 2025

Course Materials

<u>"Director Independence: Recurring Issues and Recent Developments"</u>

Wednesday, March 5, 2025

2 to 3 p.m. Eastern [archive and transcript to follow]

Twenty-plus years into the stock exchanges' corporate governance requirements, boards and their advisors had gotten pretty comfortable navigating questions of director independence. But public companies are now considering whether and how to tighten their procedures in light of recent developments — including the SEC's settlement with a public company director due to his failure to disclose his close personal friendship with an executive officer and the Delaware Chancery Court's *Tornetta* decision invalidating Elon Musk's 2018 pay package, in which director independence played a significant role. Join our speakers as they discuss recurring issues, recent developments and some common scenarios.

Joining us are:

- **Caroline Kim**, Skadden
- **Bob Lamm**, Gunster
- **Kyoko Takahashi Lin**, Davis Polk
- **Kyle Pinder**, Morris Nichols

Among other topics, this program will cover:

1. Back to Basics: How the Rules Work
    - Listing requirements
    - Nasdaq & NYSE categorical standards
    - Catch all
    - Recent SEC enforcement action

2. Committee Considerations
    - Compensation Committees
    - Audit Committees
    - Nominating/Corporate Governance Committees

3. Preparing for Proxy Season
    - Process and frequency of determinations
    - Proxy disclosure regarding director independence

- Investor and proxy advisor perspectives, including tenure considerations

4. Delaware Law
   - Case law basics
   - Recent developments
   - Process considerations
   - Senate Bill 21

5. Discussion of Considerations in Common Scenarios (time permitting)

<u>**“Director Independence: Recurring Issues and Recent Developments”**</u>

Course Outline

1. Back to Basics: How the Rules Work

    - Listing requirements

        - Sections 303A.01 and 303A.02 of the NYSE Listed Company Manual; Nasdaq Rule 5605

            - Require the board to be majority independent

            - Require the board to affirmatively determine that the director has no material relationship with the company

            - Provide “bright line” tests that preclude an independence determination

    - Categorical standards

        - Section 303A.02(b) of the NYSE Listed Company Manual; Nasdaq Rule 5605(a)(2)

        - Persons in these categories may not be considered “independent” by the board under any scenario (*i.e.*, they are *per se* not independent). The following is a non-exhaustive list of examples of relationships that preclude an independence determination for both NYSE and Nasdaq companies:

            - Directors employed by the company

            - Directors who received (or who have a family member who received) more than $120,000 in compensation from the company, with certain exceptions

            - Directors who are partners of the company’s outside auditor or have other relationships with the company’s outside auditor

        - Directors who have compensation committee interlocks
        - Directors affiliated with organizations that the company has made payments to, or received payments from, for property and services meeting the thresholds in the stock exchange rules
            - NYSE: The greater of $1 million or 2% of the other company's consolidated gross revenues
            - Nasdaq: Exceed 5% of the recipient's consolidated gross revenues for that year, or $200,000, whichever is more

- Catch all
    - The bright line independence tests are helpful and illustrative — but not determinative — and intended to provide transparency to investors and companies, facilitate uniform application of the rules and ease administration
    - A director who meets all of the bright line independence criteria set forth in Section 303A.02(b) of the NYSE Listed Company Manual or Nasdaq Rule 5605(a)(2) isn't automatically presumed to be independent; the board still must make an affirmative determination that each director has no material relationship with the company
- Recent SEC enforcement action
    - In an October 2024 enforcement action (*SEC v. Craigie*), the SEC targeted a former CEO and director who did not disclose a close personal friendship with a company executive that the SEC contended resulted in misleading proxy disclosures concerning his independence
    - Without admitting or denying the SEC's allegations, the former director agreed to a five-year D&O bar and a $175,000 civil penalty

2. Committee Considerations

- Compensation Committees
  - Independence requirements
    - SEC Rule 10C-1; Sections 303A.02(a)(ii) and 303A.05 of the NYSE Listed Company Manual; Nasdaq Rule 5605(d)(2)
      - Each member must be independent
      - In determining independence, the board must consider all factors specifically relevant to determining whether a director has a relationship to the company that is material to the director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:
        i. The source of the director's compensation, including any consulting, advisory or other compensatory fee paid by the company to the director
        ii. Whether the director is affiliated with the company, a subsidiary or an affiliate of a subsidiary of the company
  - Considerations for equity grants
    - Exchange Act Rule 16b-3
      - Transactions between the company and an officer or director (including employee benefit plans) are exempt from Section 16(b)'s short-swing liability for equity grants if they are

approved by a compensation committee of two or more "non-employee directors"

        - A "non-employee director" is a director who:

            i. Is not currently an officer of the company, or a parent or subsidiary of the company

            ii. Has not received compensation from the company — other than for board service — of more than $120,000 from the beginning of the company's last fiscal year (the disclosure standard of Item 404 of Regulation S-K) and

            iii. Does not possess an interest in any other transaction for which disclosure would be required under Item 404 of Regulation S-K

    - This exemption prompts most companies to require that the committee be composed of at least two non-employee directors meeting the Rule 16b-3 definition — which is typically included in the committee charter's "committee composition," "member qualifications" or comparable section

        - If not all committee members qualify as non-employee directors, the compensation committee can rely on a sub-committee made up of two or more qualified directors for purposes of granting the necessary approvals under Rule 16b-3

- Reminders for executive compensation setting

    - The committee's charter is required to set forth the committee's responsibility for determining (or recommending to the board) the compensation of the company's executive officers, so it's important to ensure all elements of compensation for all executive officers go through the committee. This can be tricky with:

        - Non-CEO direct reports who are Section 16 officers

            i. "Executive officer" means the company's Section 16 reporting officers per Exchange Act Rule 16a-1(f) (this includes the company's Chief Accounting Officer, even if they're not a member of the C-suite or a direct report to the CEO)

        - Perks, to the extent the company doesn't have — or follow — a formal perk policy approved by the compensation committee

    - Especially where compensation is more likely to be challenged in litigation, consider whether the directors will be considered independent under Delaware case law

- Audit Committees

    - Independence requirements

        - SEC Rule 10A-3; Section 303A.06 of the NYSE Listed Company Manual; Nasdaq Rule 5605(c)(2)

            - Each member must be independent

            - In order to be considered independent, a member of an audit committee may not, other than in his or her capacity as a member of the audit committee, the board, or any other board committee:

i. Accept directly or indirectly any consulting, advisory, or other compensatory fee from the company (with limited exception)

- “Indirect” acceptance includes acceptance by a spouse, a minor child or stepchild or a child or stepchild sharing a home with the member or by an entity in which the audit committee member is a partner, member, an officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the company

ii. be an affiliated person

- Nominating/Corporate Governance Committees
  - Under Section 303A.04(a) of the NYSE Listed Company Manual, companies are required to have a nominating/corporate governance committee composed entirely of Independent Directors

        - "Independent" refers solely to the NYSE's general independence definition and satisfaction of the bright line independence tests — there are no enhanced independence standards that pertain to the nominating/corporate governance committee — and there are no other rules or regulations that commonly bear on committee member independence unless the committee has been charged with other (*i.e.*, non-required) functions that trigger other independence considerations

    - Under Nasdaq Rule 5605(e), director nominees must be selected, or recommended for the board's selection, either by:

        - Independent Directors constituting a majority of the Board's Independent Directors in a vote in which only Independent Directors participate, or

        - A nominations committee comprised solely of Independent Directors

3. Preparing for Proxy Season

- Process and frequency of determinations

    - A formal review of every director's independence should be conducted annually in connection with the preparation of the proxy statement (or more frequently)

    - Review of independence status may also be appropriate upon:

        - Changes in an individual director's circumstances: Companies' corporate governance guidelines or other policies often require that directors report changes in their circumstances — including board affiliations, principle occupation, employers, etc. (sometimes in connection with director resignation policies) — to the nominating/ governance committee

    - Changes in independence rules, standards or policies may warrant a current review of independence status of all directors or a subset
    - Addition of new directors: Independence should be evaluated as part of the director recruiting process
- It is not enough to rely on questionnaire responses from directors as the exclusive source for information to guide independence determinations
    - Companies need to do their own diligence to supplement the questionnaire responses, but the extent of the diligence will depend on a number of factors — such as the size, business and organizational structure of the company
    - For most companies, this process commonly includes compiling a master list of all companies, entities and individuals with which each director is affiliated — and then providing the list to the company's accounting department (and perhaps other major business units) to identify and provide information about transactions between the company and any of the director-affiliated companies on the list
- Who decides? The nominating/governance committee typically reviews the information and, subject to potentially requesting additional information/follow-up, makes its own determination for recommendation to the board
    - Then the nominating/governance committee presents its recommendation — or the corporate secretary presents the committee's recommendation — to the board, and the board makes affirmative determination as to each director's independence
- Some companies use categorical independence standards to make this process more efficient

- Information presented to the board will ultimately need to be disclosed in the proxy statement (see below)

- Proxy disclosure regarding director independence

  - Item 407(a) of Regulation S-K requires companies to identify each director and nominee for director that is "independent" under the applicable standard, generally based on the standards of the stock exchange on which the company's common stock has its principal listing

  - Item 407(a)(3) specifically requires that the company describe by specific category or type any transactions or relationships not disclosed pursuant to Item 404(a) that were considered by the board in evaluating the independence of directors

    - This means that, even if a transaction is not considered "material" — and therefore doesn't need to be disclosed as a related party transaction under Item 404(a) — it still needs to be fully described in the independence disclosures if the board considered it in its independence determination

- Investor and proxy advisor perspectives, including tenure considerations

  - Some investor and proxy advisor independence policies are different than the stock exchange "bright line" standards

  - For example:

    - Many of the tests in the ISS policy — like the professional services and transactional tests — look only at current relationships and do not have a lookback, unlike the NYSE and Nasdaq tests, so, generally speaking, when a prohibited relationship is terminated (*e.g.*, the listed company stops making purchases from a director's company), a director can be classified as independent without having to wait three years

  - But note that ISS will not classify a director as independent if the board itself is not able to do so

- Under the ISS Policy, a former CEO of the company will be classified as a Non-Independent Non-Executive Director

  - This means that any past CEO of the company (including prior to the IPO) — regardless of how much time has passed since they served in that role — will be considered non-independent by ISS

- ISS uses a $10,000 threshold for determining independence of a director who provides (or whose company provides) professional services to the company — as compared to the $1 million/2% or $200,000/5% threshold (depending on whether the company is NYSE- or Nasdaq-listed) applied for other transactional relationships

  - There's no lookback to this like the NYSE/Nasdaq rules — ISS does mean "currently" — so if the arrangement is in the past, but disclosed in the proxy, the company should make it absolutely clear as to when it ended and that it does not expect to pick up the arrangement again

- In addition to including a lower dollar threshold, the prohibited affiliations under the professional services test are more inclusive than under the transactional test

- For a director to be considered affiliated under the professional services test, the director (or immediate family member) only has to be an employee of the organization providing the professional service — as opposed to an executive officer in the case of a transactional relationship

4. Delaware Law

- Case law basics
  - Director disinterestedness and independence often come into play in shareholder litigation — and the analysis under Delaware law is more holistic and fact-specific
  - Delaware courts have looked past the traditional financial thresholds and into softer factors such as close personal friendships or other relationships that are of a "bias-producing nature"
- Recent developments
  - "Superstar" CEOs and consideration of independence in *Tornetta v. Musk*
  - Single member committees? In the April 2024 *In Re Match Group Inc. Derivative Litigation* decision, the Delaware Supreme Court determined that the entire special committee must be independent to satisfy the *MFW* standard, which, if met, lowers the standard of review for certain transactions from "entire fairness" to "business judgment"
- Process considerations
  - Transaction-specific questionnaires for potential committee members

- Research potential independence concerns to flag publicly available information that plaintiff's counsel might identify in challenging independence

- Senate Bill 21

  - Introduced in the Delaware Senate Judiciary Committee on February 17

  - Would redefine independence for public companies to incorporate federal stock exchange standards with the board determination presumptively controlling unless a plaintiff shareholder pleads "substantial and particularized facts" evidencing the director's material interest in the transaction or material relationship with a person with a material interest

  - Would change the playing field for approval of controlling shareholder transactions by, among other things, (i) fixing a minimum 1/3 ownership requirement, under which a shareholder cannot be deemed a controller and (ii) providing a safe harbor if the transaction (other than a going private transaction) is approved or recommended by the majority of the members of a committee consisting of two or more directors who the board determines are disinterested, or approved or ratified by a majority of disinterested stockholders (not both per *MFW* and *Match*)

5. Considerations in Common Scenarios (roundtable discussion, time permitting)

   - Former executive or founder now a non-employee director

   - Non-employee director serves as Interim CEO

   - Immediate family member of a non-employee director is executive at supplier company purchased from two years ago

   - Non-employee director serves as trustee of organization that received charitable contributions from company in the last year

- Non-employee director is a partner at a venture capital firm that owns 12.7% of company's common stock

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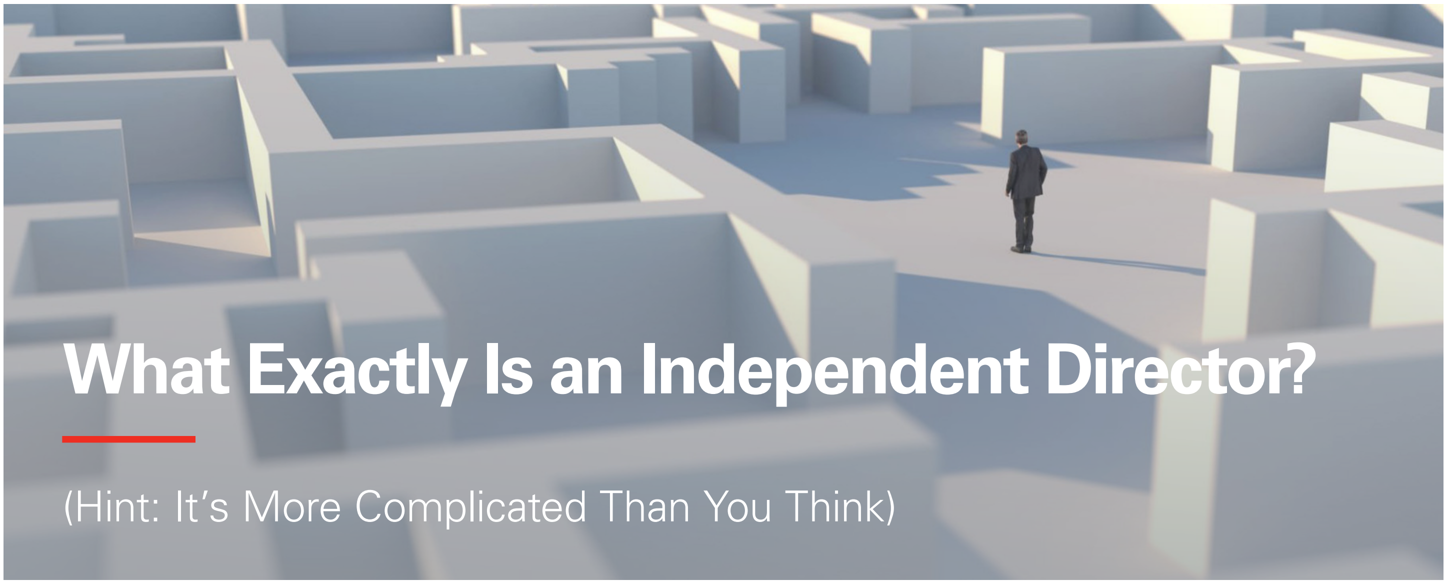
Skadden



What Exactly Is an Independent Director?

(Hint: It's More Complicated Than You Think)

– Independence is neither a fixed condition nor a universal status for all purposes. Events and relationships can disqualify an otherwise independent director from participating in decisions.

– No matter how pure a director's motives, if they are not alert to independence issues, plaintiffs may portray them as compromised, which could jeopardize board actions.

– Courts are sensitive to personal and business relationships they fear could make directors too deferential to management or controlling shareholders.

Independence is not as simple as it sounds. As a director, you may be considered independent for one purpose but not another, and the fact that you qualified as independent in the past does not mean you will in all future situations. It is essential to understand the rules governing director independence and to be sensitive to the circumstances that can trip up boards and directors.

The most important thing to bear in mind is that independence is not a once-and-for-all test, something to consider when you are appointed and then treat as settled. Circumstances change for both individual directors and companies, and independence is situational: It must be reassessed as events unfold, particularly where a company enters negotiations or transactions or makes decisions about management.

Who Sets the Rules?

There are several sources of standards governing director independence: stock exchange listing requirements, Securities and Exchange Commission (SEC) regulations, proxy advisories and the laws of the state of incorporation.

The SEC regulations and stock exchange rules are relevant mainly when directors are appointed and named to key committees. However, once on a board, the issue of whether a director is independent comes up primarily in litigation, when board actions are challenged by shareholders claiming that directors had ulterior motives, divided loyalties or conflicts of interest. Most often, these cases are heard in the courts of Delaware, where more than two-thirds of Fortune 500 companies are incorporated.

> *One decision referred to a controlling shareholder "as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support)."*

Stock exchange rules. Both the New York Stock Exchange and Nasdaq require that listed company boards have a majority of independent directors, and each exchange sets criteria. The focus is on independence from management so directors can exercise autonomous judgment. To qualify as independent for this purpose, directors cannot hold management positions at the company, its parents or subsidiaries, and former executives are not considered independent for three years after their departures. Other rules are meant to ensure that independent directors are not overly reliant on the company financially. For example, a director does not qualify as independent if they or their families received more than $120,000 in compensation from the company in any 12-month period in the prior three years. These standards make sense, since their purpose is to ensure that board members act at an arm's length from management and controlling influences.

Directors also need to keep in mind that proxy advisory firms sometimes apply more stringent independence tests than the stock exchanges. A proxy advisor may not consider a director nominee independent and may recommend that shareholders not vote for that nominee, even if the person is deemed independent under the stock exchange standards.

Delaware law. Delaware law is much more situation-specific and has focused on ensuring directors remain free of conflicts during particular board actions.

Much of the relevant Delaware law governing director independence has evolved through litigation over transactions involving an insider or controlling shareholder, where approval by independent outside directors is required. These situations can place directors' conduct under a microscope. And, no matter how pure a director's motives and how dedicated they are to doing the right thing, if not alert to established guidelines on independence and not considering them on an ongoing basis, they may set themselves up to be attacked by plaintiffs as compromised and conflicted. They could also face personal liability for their role in board actions if they are ultimately found to have breached their fiduciary duties.

Situations That Can Cast Doubt on Directors' Independence

Few shareholder lawsuits go all the way through a trial. As a consequence, much of the law governing director conduct stems from rulings made in the early stages of litigation, where judges are not evaluating both sides' evidence but must accept the plaintiffs' allegations as true. That is, the court is only considering whether the facts the plaintiffs allege would be sufficient to undermine the directors' independence if proven at trial.

Even if the matter is ultimately resolved favorably for the directors, being named as a defendant in a shareholder suit is not ideal. Using news reports and corporate records demands, plaintiffs can — and regularly do — frame detailed allegations that portray board decisions as compromised due to conflicts of interest or divided loyalties. You do not want to provide anyone ammunition by doing something that could be misconstrued as conflicted.

Self-interest. Cases involving conflict due to self-interest are relatively straightforward. For example, in one case, directors refused at the last minute to execute a restructuring agreement for their company unless it included a broad release and indemnity for the directors and majority shareholder. When a shareholder sued the directors for breach of fiduciary loyalty, a court refused to dismiss the case on the pleadings. (A possible solution: Leave the decision about the releases to newly-appointed independent directors who were not involved in the actions that gave rise to the claims and who are not defendants.)

Relationships with interested parties. Less obvious examples of potential conflicts involve multi-dimensional relationships between outside directors and interested parties — typically management or large shareholders.

Delaware courts have repeatedly focused on ongoing business and personal ties that could make it hard in practice for nominally independent directors to exercise truly independent judgment in the company's interest. Plaintiff's lawyers are adept at mustering details to make it appear that outside directors are so cozy with management or a controlling shareholder that they are not independent.

Several leading cases involve a CEO, board chair or controlling shareholder alleged to be on both sides of a transaction — where the director's company acquired a company in which the insider had a sizeable stake, for example. Other cases are styled as shareholder derivative suits, where the plaintiffs, suing in the company's name, argue that the board should have sued management for some action or failing. Relationships between directors and management typically are front and center in such litigation.

For veterans of the business and financial world, some of the ties courts have cited as undermining independence may seem routine and harmless. For example, the independence of venture investors on public company boards has been challenged because their ties to management are valuable in their own businesses.

– In one case, an outside director was a partner in a venture capital firm that invested in a sector where the company regularly made acquisitions, and the director also served on the board and was an investor in another business that was dependent on the company for an important approval. A court said the director might be reluctant to disagree with management for fear of losing his board seat.

– In another case, a court said that outside directors might not be independent of the founder and controlling shareholder where their venture capital firm invested in the company early on and held shared investments with the founder. Venture capitalists "compete to fund the best entrepreneurs," the court noted, adding that, while "[t]here is nothing wrong with that, these relationships can give rise to human motivations compromising the participants' ability to act impartially toward each other ... ."

Where directors have been named to several boards by the same interested party or shareholder, that has raised red flags for some courts and other observers:

– In a 2021 case involving a special purpose acquisition company (SPAC), the court noted that most of the outside directors had served on at least five other SPACs formed by the same sponsor, which the court said could suggest the directors might expect future board appointments. In addition, the sponsor had granted the directors founders' stock, the value of which would rise no matter what deal was consummated, while common shareholders would only benefit from a sound, well-priced acquisition.

– Similarly, where members of a special committee evaluated the acquisition of a business controlled by their company's chair, a court noted that one outside director had served on the boards of four companies controlled by the chair over two decades. Two other members of the special committee had also served as directors of other companies the chair controlled.

– A recent law review article noted that a group of 15 directors had served on 252 boards of bankrupt companies which were represented disproportionately by two law firms. The authors argued that such repeat players suffer from "structural bias," favoring the release of claims.

Directors should be mindful that serving on the board of a company with a long-time board chair, founder or controlling shareholder may give rise to scrutiny of transactions involving that person. Delaware judges have been attuned to the personal dynamics at such companies. Several decisions have cited newspaper and magazine articles portraying larger-than-life personalities. Reports that CEOs or chairs have a history of retribution against directors who opposed them have also been cited. For example:

– Where for five consecutive years, shareholders had voted against a compensation committee's recom-

Courts have allowed suits to go forward where plaintiffs alleged directors were not independent because they:

- ☐ were named to other unrelated corporate boards by the CEO, chair, controlling shareholder or financial sponsor.
- ☐ served on the board of a college alongside the interested party, who was a major donor to the school.
- ☐ were partners in a venture capital firm that invested in sectors where the company makes acquisitions.
- ☐ shared investments or assets such as a private plane with the CEO, chair or controlling shareholder.
- ☐ received token benefits from an interested party, such as a private museum tour for relatives, while a transaction was under consideration.

mendations for executive pay, and a majority of noninterested shareholders repeatedly withheld their votes for the committee members who approved the pay packages, a Delaware court concluded that "the only reason these directors have not been forced to resign is [the CEO's] continuing support." That support could suggest the committee members were beholden to the CEO, the court said.

– In particularly colorful language, one decision referred to a controlling shareholder "as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support)."

Finally, personal interactions that might seem innocent and routine to successful business people, such as shared charitable interests and personal favors, may be fodder in litigation where director independence is at issue:

– The independence of two outside directors on a special committee was called into question where the company chair was a longtime member of the board at his alma mater alongside two of his company's directors, and he had donated tens of millions of dollars to the college, including large sums while one director held a senior administrative position at the school. The chair also arranged a private museum tour in London for the wife and daughter of one of the directors while the special committee was evaluating the transaction with him.

– An outside director who, with her husband, owned a small private plane with the company's controlling shareholder and former CEO, whose actions the board had approved, was likely too close to the CEO to be considered independent, the Delaware Supreme Court held. "Co-ownership of a private plane involves a partnership in a personal asset that is not only very expensive, but that also requires close cooperation in use, which is suggestive of detailed planning indicative of a continuing, close personal friendship …" the court said, "the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment."

Conclusion

The takeaway is that outside directors need to closely monitor their independence and understand that the term can mean different things for different purposes.

A director who qualifies as independent to sit on an audit or compensation committee may not be deemed so when it comes to approving a transaction with an insider or assessing a shareholder demand to bring litigation claims against management. In the latter cases, courts will retroactively assess the possibility of subtle biases and conflicts stemming from personal or business relations — a more refined and less predictable standard of independence.

To ensure your ability to exercise independent judgment and reduce the chances of ending up in court, or losing there, be sensitive to both personal conflicts of interest and relationships and actions, whether recent or long-term, that could appear to create divided loyalties.

Authors

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This article is from Skadden's *The Informed Board*.

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The Securities Edge

SECURITIES AND CORPORATE GOVERNANCE BLOG FOR MIDDLE MARKET COMPANIES

Law and Order: SEC

By Robert B. Lamm on October 2, 2024

You may have noticed that the SEC has been very quiet on the rulemaking front in recent weeks. It comes as no surprise, as action on a number of items on the SEC's **Regulatory Flexibility Agenda** had been moved from late 2024 to early 2025. (The cynic in me wonders whether the scheduling changes resulted from concerns that accusations of over-regulation would impact the 2024 election cycle, but – for now, at least – I'll leave that to others.)

However, the SEC has definitely not been idle. Quite the contrary. In fact, recent weeks have seen what strikes me as an inordinate number of announcements of enforcement actions. Some of these actions are relatively "standard" – insider trading, recordkeeping violations, securities fraud, whistleblower protection violations (discussed in **our recent e-alert**), and so on. But others are somewhat unusual. For example:

- On September 24, the SEC announced the settlement of **charges against 23 entities and individuals for failing to timely file Schedules 13D and 13G and Forms 3, 4, and 5**

regarding beneficial ownership of securities. Two public companies were also cited for "contributing to filing failures by their officers and directors and failing to report their insiders' filing delinquencies." It's not the first time that the SEC has brought such charges, but they are relatively infrequent. Moreover, the civil penalties assessed in the recent round of settlements were high – in one case, $750,000 – and totaled $3.8 million, and involved some well-known names in the financial services industry.

- Two days later, the SEC reported that it had **charged a company with "selectively disclosing material, nonpublic information to investors who followed…the company's CEO's social media accounts** without disclosing that… information to all investors, in violation of Regulation Fair Disclosure (FD)." I may be mistaken, but it seems to me that the SEC has not brought a great many enforcement cases on Reg FD in recent years, and the focus on social media also seems like something of a blast from the past.

- However, the case that intrigues – and concerns – me the most is one announced on September 30, in which **the SEC charged an independent director and former CEO of a company with concealing a close relationship with a company executive**, allegedly in violation of the proxy disclosure rules. According to the SEC's announcement, the director/former CEO "standing for election as an independent director" concealed from the board "his close personal relationship" with a senior executive. The director/former CEO "frequently vacationed with the executive and the executive's spouse," paying more than $100,000 for them to join him and his spouse on several international vacations. He never disclosed the relationship and "allegedly encouraged the executive to conceal the relationship". And, when the company began a CEO succession process, the director/former CEO "allegedly shared confidential details about the process with the executive and took steps to better position the executive for succession in the future." The company eventually learned of the relationship and determined that the director/former CEO was not independent.

Why does this case concern me? Of course, once the board learned of the actions taken by the director/former CEO, it had every right to determine that he was not independent. However, it's not at all clear to me that the actions in question violated the proxy rules. There have been many cases over the years in which directors were alleged – often by investors and/or the media – to have lacked independence because they belonged to the same country club, served on the same boards (including boards of charitable organizations), or generally hung out in the same social circles. Some of these cases generated calls for SEC rulemaking that would require disclosure of these informal relationships and thereby disqualify directors in such cases from being described as independent. However, for whatever reason (and I can think of a few), the SEC never took such action.

Similar situations have also resulted in judicial decisions disqualifying such directors from serving on committees of independent directors. Perhaps the most famous of these cases is a Delaware Chancery Court opinion, written by Leo Strine, in which two directors of Oracle were disqualified from serving on an independent committee due to their ties to Stanford University, which had received substantial donations from Oracle and/or certain of its directors.

However, to my knowledge, none of the cases referred to above resulted in an SEC enforcement action. In fact, the two Oracle directors continued to be listed as "independent" in Oracle's proxy statements, and, to my knowledge, the SEC never brought a case against them or objected to the characterization in the proxy statements.

The bottom line is that while the SEC may not have engaged in much rulemaking in recent weeks, it may be creating new rules through the enforcement process, and that strikes me as disturbing.

By the way – for anyone who feels misled by the title of this post, I have two words for you: dun-dun.

Gunster