INSIGHTS

The Corporate & Securities Law Advisor

VOLUME 36, NUMBER 4, APRIL 2022

Wolters Kluwer

www.WoltersKluwerLR.com

INSIGHTS

The Corporate & Securities Law Advisor

Editor-in-Chief
BROC ROMANEK
broc.romanek@gmail.com

EDITORIAL OFFICE
28 Liberty Street,
New York, NY 10005
212-771-0600

Wolters Kluwer
Richard Rubin, Publisher
Jayne Lease, Managing Editor

INSIGHTS (ISSN No. 0894-3524) is published monthly by Wolters Kluwer, 28 Liberty Street, New York, NY 10005. To subscribe, call 1-800-638-8437. Customer service, call 1-800-234-1660 or visit www.wolterskluwerlr.com.

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CYBERSECURITY

Navigating a Security Incident: Communication "Dos" and "Don'ts"

By Amy de La Lama, Christian Auty, Daniel Rockey, and Logan Parker

The security incident response process inevitably brings a myriad of challenges for a company unfortunate enough to experience one. Although implementing an appropriate communication strategy may not be at the top of the list of the initial concerns for a company in the throes of a ransomware attack or other type of security incident, it should be. Appropriate communication discipline will help protect attorney-client privilege and similar legal protections and mitigate the significant risks (legal, reputational, financial) associated with the unintended disclosure of incident-related communications.

With this in mind, we have included below a set of "*Communication Dos and Don'ts"* to help companies approach this aspect of the incident response process. To implement the Dos and Don'ts, we recommend that companies work these principles into their Incident Response Plan and disseminate them to the incident response team at the outset of every incident response effort.

It also will be important to remind internal teams and external service providers that while copying internal or external legal counsel on communications, as well as designating materials as subject to Attorney-Client Privilege and/or designating materials as "Work Product," are important steps, doing so will not automatically create relevant legal privileges.

Moreover, there is always the risk that communications may inadvertently be sent to the wrong recipients and/or acquired either as part of the legal process or by the bad actors themselves. Therefore, thinking carefully about the content and manner of dissemination is essential in mitigating the inevitable fall-out from a security incident and moving forward as quickly as possible.

Amy de La Lama, Christian Auty, Daniel Rockey, *and* **Logan Parker** *are attorneys of Bryan Cave Leighton Paisner LLP.*

Communication Dos

- **DO** communicate via telephone when possible.
- **DO** include a Project Name (for example, "Project Yellow: Notification Content") in all emails and other written communications.

In certain situations, a communication may need to go to a smaller group. In those instances, the remaining Dos and Don'ts should still be followed.

- **DO** mark any emails concerning legal opinion, legal analysis, litigation strategy and risk as "Privileged and Confidential" and include designated counsel (internal and/or external counsel) on all such communications.
- **DO** designate emails as "private."
- **DO** limit email content to factual and/or objective information, when possible. If an email communication contains work product or content subject to the attorney-client or legal professional privilege, do not forward it to anyone outside of the original distribution list.
- **DO** assume that any written communication might ultimately be discoverable or made public at some point (that is, White Board Test).
- **DO** segregate written communications in a separate, designated (protected) location and maintain communications in accordance with any litigation hold instructions.
- **DO** start a new email thread and be mindful of the necessary recipients of information

contained in the email. Send the email to only those with a need to know the information and confirm the recipient list before hitting send.

Communication Don'ts

- **DO NOT** include subjective conclusions/assessments (for example, "this was a big mistake," "our systems were not adequately protected") in email communications.
- **DO NOT** circulate forensics or other reports via email, particularly in draft form. Reports should be reviewed using a screen sharing application or similar means, and any dissemination via email or otherwise should be done only when the report has been finalized and at the direction of counsel.
- **DO NOT** communicate about the incident via other unofficial means (for example, texts, instant messaging, other non-company communication applications), unless the nature of the incident mandates use of an approved secondary communication method.
- **DO NOT** destroy or delete any written communications related to the incident until receiving specific instructions to do so.
- **DO NOT** forward email communications.
- **DO NOT** continue to use the same email thread for new topics and avoid reflexive "reply all" responses.
- **DO NOT** mix legal and business advice; use separate communications.

When in doubt, pick up the phone and obtain input from either your internal or external legal counsel prior to sending a written communication. Communication is a key and integral component of a strong response to incidents. Having and following your protocol provides a mechanism for rapidly notifying stakeholders, and coordinating internal and external stakeholders, monitoring customer or employee sentiment, and minimizing reputational damage, all while protecting your company's interest and legal privileges.

The SEC Proposes Cybersecurity Disclosure Rules! 4 Things to Know

By Allison Handy

On March 9, 2022, the Securities Exchange Commission (SEC) proposed cybersecurity disclosure rules.[1] This proposal was much anticipated as it is no secret that cybersecurity incidents are one of the more serious types of risk that any company faces today.

As highlighted in SEC Chair Gary Gensler's statement, the intent of the rules is to make disclosures regarding cybersecurity more "consistent, comparable, and decision-useful."[2] Overall, the proposed rules are fairly prescriptive, consistent with other recent SEC proposals and a departure from the more principles-based focus of rulemaking under the prior SEC Chair. For cybersecurity topics, the specificity may be helpful to companies in determining how to craft disclosures.

But, as noted in Commissioner Hester Peirce's dissenting statement, "the proposed rules pressure companies to consider adapting their existing policies and procedures to conform to the Commission's preferred approach."[3] The comment period extends until the later of May 9th or 30 days after publication in the Federal Register.

Here are four things to know about the proposal.

***Allison Handy** is a partner of Perkins Coie LLP and a contributor to PublicChatter.com.*

1. Form 8-K Disclosure of Cyber Incidents, with Materiality-Linked Trigger

The proposed rules include new Form 8-K Item 1.05, which would be triggered by a company's determination that it has experienced a *material cybersecurity incident*. Notably, just as other Form 8-K items that rely on materiality determinations, the proposal provides that an untimely filing would not result in a loss of Form S-3 or Form SF-3 eligibility.

By making the disclosure trigger dependent on a company's determination that a material incident has occurred, the proposal provides needed flexibility in what can be a complicated process of assessing the effect of an incident. The proposal also places guardrails on this flexibility, including an instruction that "a registrant shall make a materiality determination regarding a cybersecurity incident as soon as reasonably practicable after discovery of the incident."

In her comments during the open Commission meeting, Commissioner Allison Herren Lee called on commenters to provide insight on whether this flexibility makes the disclosure threshold too flexible. Similarly, the proposing release asks whether Form 8-K disclosure should be triggered by *any* cybersecurity incident. If the final rules were to require Form 8-K disclosure of all cybersecurity incidents, companies may face incredibly burdensome challenges in making meaningful and accurate disclosure in all cases, particularly considering the four-business day reporting requirement.

Cybersecurity incidents are an incredibly challenging areas for disclosure controls and materiality determinations. Companies on the one hand don't want to jump the gun and disclose a cybersecurity incident that makes it look more serious than it is. But they should want to get disclosure about an incident out there as soon as possible—if it's material—to stave off any potential litigation. It's a tough road to navigate, particularly if the extent of an incident takes time to sleuth out accurately once the incident is detected.

2. Periodic Report Disclosures for Updating Form 8-K Disclosures

Two parts of proposed new Regulation S-K Item 106 would create requirements to update or supplement Form 8-K disclosures regarding cybersecurity incidents:

i. Proposed Item 106(d)(1) would require disclosure of material changes, additions or updates to information included in the Form 8-K.
ii. If a company experienced a series of immaterial cybersecurity incidents that have become material in the aggregate, proposed Item 106(d)(2) would require disclosure in a periodic report (Form 10-Q or Form 10-K for the fourth quarter) for the quarter in which the company determines the incidents are material in the aggregate.

These requirements are akin to many other SEC reporting requirements for quarterly updates.

3. Form 10-K Disclosures

Proposed Regulation S-K Item 106 also covers disclosures that would be provided annually in Form 10-K in two categories:

i. *Risk management and strategy*—Companies would be required to discuss, as necessary to adequately describe their policies and procedures, topics including risk assessment programs, risks associated with third-party service providers, and risks and incidents that have affected or are reasonably likely to affect the company's results of operations or financial condition.
ii. *Governance*—Companies would be required to discuss both the board's role in oversight of cybersecurity risk, and management's role in assessing and managing cybersecurity risks and implementing related policies, procedures, and strategies.

For management's role, the proposal calls for disclosure of the relevant expertise of the company's chief information security officer and other members of management responsible for measuring and managing cybersecurity risk. A disclosure requirement about management expertise, which would potentially include managers beyond a company's executive officers, would be unusual in the SEC's disclosure framework.

4. Proxy Disclosure of Board Cybersecurity Expertise

The proposal would also amend Regulation S-K Item 407 to elicit disclosure regarding the cybersecurity expertise of board members, if any. This disclosure would be included in Part III of Form 10-K, meaning it would typically be disclosed in the proxy statement.

Unlike the board financial expert disclosure that is already required, the proposal would require disclosure of any details necessary to describe the nature of the expertise. For good reason, there already has been a push by many boards to add directors with cybersecurity expertise. For those boards that don't currently have directors with this kind of expertise, the SEC's proposal might serve as a wake-up call.

Notes

1. *https://www.sec.gov/news/press-release/2022-39.*
2. *https://www.sec.gov/news/statement/gensler-cybersecurity-20220309.*
3. *https://www.sec.gov/news/statement/peirce-statement-cybersecurity-030922.*

D&O INSURANCE

Delaware General Corporation Law Amendments Expressly Authorize Captive D&O Insurance

By John Mark Zeberkiewicz

On February 7, 2022, the Governor of the State of Delaware signed legislation amending Section 145 of the Delaware General Corporation Law (DGCL)[1] to expressly authorize Delaware corporations to use captive insurance—which is generally defined for these purposes as insurance provided by a wholly-owned subsidiary of the corporation funded solely by the corporation—to protect directors, officers and others (covered persons)[2] against various expenses, losses and liabilities.

Subject to a narrow set of limitations, corporations may use captive insurance to protect their covered persons even under circumstances where they would be prohibited from indemnifying them. The amendments afford Delaware corporations the opportunity to take advantage of captive insurance arrangements when designing their D&O insurance programs.

Background

The amendments to Section 145 were adopted against the backdrop of a hardening market for directors' and officers' insurance (D&O insurance) in which corporations were facing marked increases in premiums for diminishing levels of coverage. That trend, which has been underway for a few years, cannot be traced to a single source but is instead the result of a confluence of factors, including:

- The rise of litigation finance firms;
- The US Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*,[3] which allowed plaintiffs to bring claims under Section 11 of the Securities Act of 1933 in state court venues where these claims tend to survive motions to dismiss more often and are otherwise more costly to litigate (and are sometimes concurrently litigated in federal court);
- An increase in event-driven litigation, including cybersecurity claims, claims premised on calamitous events, and claims against directors for breach of the duty of oversight following the Delaware Supreme Court's opinion in *Marchand v. Barnhill*;[4]
- An increase in social-justice related litigation linked, for example, to the #metoo movement; and
- Litigation related to the COVID-19 pandemic, including D&O insurance claims arising from bankruptcy proceedings of corporations the pandemic pushed to insolvency.[5]

The end result has been suits that tend to survive longer and are therefore more costly to defend and settle. In response, insurance carriers have raised premiums, lowered policy limits, fought to provide excess rather than primary coverage in the tower, and introduced new exclusions.[6]

At the time the legislation was first being discussed, industry commentators were observing that "price hikes of up to 50% [were] common, with some outliers even higher" and that companies could "expect triple-digit rate increases in a post-COVID world, as insurers respond to legacy issues such as

***John Mark Zeberkiewicz** is a Director of Richards, Layton & Finger, P.A. in Wilmington, DE. Attorneys at Richards, Layton & Finger, including the author, were involved in drafting the legislation described in this article, but the views expressed herein are the views of the author and are not necessarily the views of the firm or its clients.*

increased litigation, litigation financing, and keeping up with emerging claims and litigation due to COVID-19."[7] The challenging market for D&O insurance was deemed "likely to continue for some time."[8] To deal with the spikes in premiums and limitations or exclusions on coverage, some corporations began buying less insurance by, for example, agreeing to higher retention amounts and converting part of their comprehensive coverage into Side A coverage (which is generally the coverage that applies to liabilities stemming from claims asserted against covered persons that are not indemnifiable by the corporation).[9]

While corporations could elect to limit or forego entirely Side B coverage (which is generally the coverage that insurance the corporation for indemnification payments made to covered persons), and rely solely on structural indemnification provisions and indemnification agreements, they could not adequately protect their covered persons through indemnification arrangements alone, due to statutory limitations on the corporation's power to indemnify its covered persons.

Statutory Framework

The power of a Delaware corporation to indemnify covered persons derives principally from Section 145 of the DGCL, which, as it relates to indemnification, is divided into two basic parts. Section 145(a) of the DGCL permits a corporation to indemnify covered persons in connection with actions other than those brought by or in the right of the corporation (*i.e.*, third-party claims), while Section 145(b) permits a corporation to indemnify covered persons in connection with actions brought by or in the right of the corporation, including derivative actions.[10]

Each subsection sets forth procedures for determining the corporation's power to indemnify its covered persons, and each subsection establishes the scope of indemnification permitted thereunder.[11] The most noteworthy difference between the scope of indemnification available under Section 145(a) and Section 145(b) is that the former permits indemnification against "judgments, fines and amounts paid in settlement," while the latter does not.[12]

The distinction between Sections 145(a) and 145(b) evidences the public policy that where the corporation has been injured by one of its covered persons, the corporation should not be held ultimately liable for that injury. That public policy is reflected in the commentary surrounding the adoption of the statute and in subsequent decisions of the Delaware courts. Section 145 was adopted in connection with the 1967 overhaul of the DGCL.

In 1964, Professor Ernest L. Folk, III was retained as the reporter to the Delaware Corporation Law Revision Committee. His task was to review Delaware's general corporation law and make recommendations to modernize it. The report he generated in connection with that undertaking[13] discussed the distinction between the scope of indemnification provided in third-party actions, on the one hand, and in actions brought by or in the right of the corporation, on the other hand. Professor Folk highlighted in particular the problems that permitting a corporation to indemnify covered persons in connection with derivative suits would present, including that it would "promot[e] settlement of claims which cannot be successfully defended" and therefore would "undercut[] enforcement of fiduciary duties."[14] He also noted that it would "encourage[] strike suits," given that directors could "readily settle at corporate expense," which would give rise to a "disincentive to contest charges" and would "invite[] disreputable shareholders to sue and force a costly settlement."[15] In his treatise published shortly after the adoption of the 1967 amendments, Professor Folk stated that Section 145 did not allow for indemnification of amounts paid in settlement of derivative claims because doing so "would subvert the purpose of the derivative suit of bringing faithless corporate directors and officers to account for misdeeds."[16] Section 145 as adopted by the Delaware legislature as part of the 1967 general revision was essentially as recommended by Professor Folk.[17]

Decisions of the Delaware courts following the adoption of Section 145 have confirmed the policy basis for the exclusion from Section 145(b) of indemnification against judgments, fines and amounts paid in settlement.[18] In *Arnold v. Society for Savings Bancorp, Inc.*, for example, the Delaware Supreme Court rejected the argument that a corporation should be vicariously liable for the actions of its fiduciaries under a theory of *respondeat superior*, reasoning that imposing such liability on the corporation "'would be flatly inconsistent with the rationale of vicarious liability since it would shift the cost of the directors' breach from the directors to the corporation and hence to the shareholders, the class harmed by the breach,'"[19] and "would replicate the discredited notion of awarding damages against the directors followed by indemnification of the directors by the corporation."[20]

Despite the limitations set forth in Section 145(b) on a corporation's power to provide indemnification of amounts paid in settlement by covered persons in connection with derivative actions, it has been argued that a corporation may nonetheless extend such indemnification pursuant to Section 145(f),[21] which provides that "the indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of [Section 145] shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office."[22]

Thus, Section 145(f), by its literal terms, arguably would permit a corporation, through a bylaw, agreement or vote of stockholders or disinterested directors, to obligate the corporation to indemnify covered persons for liabilities that are not indemnifiable under Section 145(b). That reading, however, is inconsistent with the basic structure of the statute, and it has been rejected.[23] Indeed, one court noted that construing Section 145(f) as empowering the corporation to indemnify against liabilities that are otherwise not indemnifiable would render other provisions of the statute meaningless.[24]

Section 145(g) of the DGCL specifically authorizes a Delaware corporation to purchase liability insurance on behalf of its directors and officers and to insure against potential liability of such directors regardless of whether the corporation has the power to indemnify the particular litigant.[25] Thus, Section 145(g) permits a corporation to insure its covered persons against expenses, judgments, fines and amounts paid in settlement, whether in a third-party action in which the covered person has not met the standard of conduct or in any action brought by or in the right of the corporation.

The statute's grant to corporations of broad powers to procure D&O insurance has been met with some criticism. "To critics, the 'bugaboo' in the D&O insurance provision is the subsection's final clause, which expressly authorizes the obtaining of insurance to cover liabilities of prospective indemnitees beyond those for which the corporation itself could directly indemnify those persons. It has been argued that Section 145(g) circumvents the otherwise salutary limits upon indemnification set out in Sections 145(a) and (b) and thereby fosters disregard of the restrains upon antisocial corporate behavior imposed by those provisions."[26]

The drafters of Section 145(g), however, believed that the market for D&O insurance would serve as an effective limit on the nature and type of conduct that would be subject to coverage, with liability for fraud, intentional misconduct and other wrongdoing being excluded from coverage.[27] They nevertheless made clear that the statute allowed the corporation to procure such coverage, if obtainable.[28]

Although Section 145(g) has long permitted corporations to obtain insurance to cover liabilities incurred by covered persons whether or not it would be entitled to indemnify them against such liabilities, before the recent amendments, it was unclear whether a corporation could use captive insurance to protect covered persons against losses and liabilities for which indemnification was not available by statute. Two leading treatises on Delaware corporate law raise the question, and each concludes that the question is not free from doubt.[29]

Approaches in Other Jurisdictions

A small minority of states currently permit corporations to effectively self-insure against judgments, fines and amounts paid in settlement of actions, suits and proceedings brought by or in the right of the corporation, with varying degrees of statutory latitude. For example, New Mexico's corporation law, which, like Delaware's, purports to disallow indemnification of judgments, fines and amounts paid in settlement by covered persons in connection with actions brought by or in the right of the corporation, provides that a "corporation shall have power to purchase and maintain insurance *or furnish similar protection, including but not limited to providing a trust fund, a letter of credit or self-insurance* on behalf of" specified covered persons, "whether or not the corporation would have the power to indemnify the person against such liability" under the applicable indemnification provisions.[30]

Nevada's corporation law, by contrast, expressly provides that corporations may purchase and maintain insurance to cover directors, officers and others or make use of "other financial arrangements,"[31] but provides that "[n]o financial arrangement made . . . may provide protection for a person adjudged by a court of competent jurisdiction, after exhaustion of all appeals therefrom, to be liable for intentional misconduct, fraud or a knowing violation of law, except with respect to the advancement of expenses or indemnification ordered by a court."[32]

The Amendments to Section 145(g)

Authorization of Captive Insurance Arrangements

The amendments to Section 145(g) authorize a corporation to purchase and maintain insurance on behalf of covered persons by or through a "captive insurance company" licensed in Delaware or another jurisdiction or through a "fronting" or other reinsurance arrangement, which occurs where a corporation procures insurance through a third-party insurer, but all of the risk of loss is transferred to a wholly-owned captive.[33] As with traditional D&O insurance, the captive insurance may provide coverage for liabilities incurred by covered persons whether or not the corporation would have the power to indemnify them under Section 145. The amendments to Section 145(g), thus, make clear that, subject to specified limitations described below, captive insurance may be used to provide protection to covered persons for, among other things, judgments and amounts paid in settlement of claims brought by or in the right of the corporation, despite the fact that the corporation will continue to lack the power to indemnify covered persons for those amounts.

Mandatory Limitations and Exclusions

While revised Section 145(g) allows for the use of captive insurance to cover liabilities incurred by covered persons, it imposes a few narrow limitations on the use of captive insurance. Under new Section 145(g)(1), a captive insurance policy must exclude from coverage, and must provide that the insurer may not make payment in respect of any loss arising out of, based on or attributable to a final adjudication with respect to: (1) any personal profit or financial advantage to which the covered person was not legally entitled, (2) any deliberate criminal or deliberate fraudulent acts, or (3) any knowing violation of law.[34]

Thus, the use of captive insurance would be unavailable, for example, in circumstances where a covered person was found, after a final judgment in the underlying proceeding, to have obtained an undue financial benefit from a self-dealing transaction or in circumstances where the covered person deliberately engaged in criminal or fraudulent transactions, such as embezzlement or securities fraud. Nevertheless, as noted in the synopsis to the legislation,

> [d]espite these exclusions, directors may be covered under a captive insurance policy

> for certain liabilities that are not exculpable under Section 102(b)(7), including non-exculpated liability stemming from so-called *Caremark* or oversight claims where there is not otherwise a finding that the directors knowingly caused the corporation to violate the law.[35]

From a practical standpoint, it is important to emphasize that the coverage exclusions in Section 145(g)(1) apply only if the enumerated "bad acts" have been established in a final adjudication in the underlying claim. (Findings in ancillary proceedings, such as proceedings to establish entitlement to coverage, do not constitute findings in the underlying proceeding.) As a result, the proceeds of the captive insurance policy are available for use in the payment of settlements of any type of proceeding, whether direct or derivative and whether or not involving allegations that a covered person engaged in the type of conduct that, if established in the underlying proceeding, would preclude coverage.

Notably, the statutory exclusions on the use of proceeds of the captive insurance policy only apply in circumstances where the corporation would not otherwise be entitled to provide indemnification against liability. Thus, although perhaps unlikely in many cases (given the standard of conduct determination required under Section 145(a) and 145(b)), it is possible that, despite a finding that a covered person engaged in the conduct referenced in Section 145(g)(1), the person may be entitled to coverage under the captive insurance policy where the covered person would have been entitled to indemnification.

No Prohibition Against Additional Limitations or Exclusions

The statutory exclusions on coverage should be viewed as minimum requirements. So long as the statutory minimum requirements are included in the captive insurance policy, the corporation has wide discretion to impose additional limitations or exclusions on the scope of coverage.

Determinations Regarding Use of Proceeds of Captive Insurance

In addition to setting minimum restrictions on the coverage that may be provided through a captive insurance arrangement, Section 145(g) prescribes the manner in which claims payment decisions must be made under the policy. Specifically, Section 145(g)(2) provides that any determination to make a payment under a captive insurance policy must be made either by an independent claims administrator or in accordance with the procedures set forth in subsections (d)(1) through (4) of Section 145 (*i.e.*, by a majority of the directors not party to the proceeding, even if less than a quorum, a committee of such directors if such directors so direct, independent counsel, or the stockholders).[36]

Notices

Although the corporation generally may implement and use a captive insurance policy without giving any specific notice to stockholders—and no approval of any court or other governmental body is required for its adoption or use—Section 145(g)(3) provides that, before any payment under the captive policy is made in connection with the dismissal or compromise of a suit brought by or in the right of the corporation as to which notice is required to be given to stockholders, the corporation must include in the notice that a payment is proposed to be made under the captive policy.[37]

Conclusion

By expressly authorizing the use of captive insurance, the amendments to Section 145(g) afford Delaware corporations additional flexibility to create programs of insurance that provide levels of protection that they believe are appropriate for their covered persons. The amendments reflect Delaware's commitment to maintaining a modern enabling corporate statute that is responsive to the needs of corporations and their constituents.

Notes

1. S.B. 203, as amended by Amendment No. 1, 151st Gen. Assem. (Del. 2022).
2. Section 145(g) identifies the class of covered persons as "any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise." 8 *Del. C.* § 145(g).
3. Cyan, Inc. v. Beaver County Employees Retirement Fund, 138 S.Ct. 1061, 200 L.Ed.2d 332 (2018).
4. Marchand v. Barnhill, 212 A.3d 805 (Del. 2019).
5. *See, e.g.*, Alice Uribe & Leslie Scism, "Companies are Paying a Lot More to Insure Their Directors and Officers," *Wall Street Journal* (June 21, 2020); "Market Update: Executive Liability," *RT ProExec* (2019); Rachel Soich, "Three Trends Increasing D&O Insurance Rates," *Property Casualty* 360 (Oct. 30, 2019); Priya Huskins, "Why D&O Insurance is Costly Despite Fewer Securities Suits," *Law360* (Sept. 2, 2020).
6. *See, e.g.*, "Market Update: Executive Liability," *RT ProExec* (2019).
7. Judy Greenwald, "D&O Rates Skyrocket in Hardening Market," *Business Insurance* (Dec. 26, 2019); Gavin Souter, "Soaring D&O Rates Set to Keep Climbing," *Business Insurance* (June 10, 2020).
8. Judy Greenwald, "Companies Can Expect Higher D&O Rates, Lower Limits," *Business Insurance* (Apr. 23, 2020); *see* Judy Greenwald, "D&O Rates Skyrocket in Hardening Market," *Business Insurance* (Dec. 26, 2019) ("There is no immediate end in sight, with experts predicting the hard market will continue over the next 18 to 24 months.").
9. "Companies Press Insurance Brokers for Workarounds to Rising D&O Costs," *Insurance Journal* (Sept. 15, 2020).
10. 8 *Del. C.* § 145. Because it applies to actions brought by or in the right of the corporation, Section 145(b) is most often implicated in connection with derivative suits. *See* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.12[A] (3d ed. 2020 supp.) ("Section 145(b) pertains to actions brought by or in the right of the corporation. Most frequently, of course, it applies to derivative suits . . . .").
11. *See* 8 *Del. C.* § 145(a) & (b).
12. *Compare* 8 *Del. C.* § 145(a) (providing for indemnification "against expenses (including attorneys' fees), ***judgments, fines and amounts paid in settlement*** actually and reasonably incurred by the person in connection with such action, suit or proceeding") (emphasis added), *with id.* § 145(b) (providing for indemnification "against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation"). *See also* 1 R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations & Business Organizations*, § 4.12[A] (3d ed. 2009 supp.) ("Section 145(b) permits indemnification *only of* expenses in derivative suits and *does not authorize indemnification of judgments or amounts paid in settlement* of derivative suits.") (emphasis in original); David A. Drexler et al., *Delaware Corporate Law & Practice*, § 16.02[2] (2021) ("The corporation may not indemnify under Section 145(b) for any amounts paid to it by way of satisfaction of a judgment or in settlement.").
13. Ernest L. Folk, III, The Delaware Corporation Law: A Study of the Statute with Recommended Revisions (1964) (hereinafter, the Folk Report).
14. Folk Report, at 89.
15. *Id.*
16. Ernest L. Folk, III, The Delaware General Corporation Law: A Commentary and Analysis, Little Brown (1972), at 100.
17. *See* Folk Report, at 95. Professor Folk's recommended statute included the distinction between indemnification for third-party actions (for which a corporation "shall have power to indemnify . . . against reasonable expenses (including attorney's fees), judgments, fines, and amounts paid in settlement actually and reasonably incurred") and indemnification for actions by or in the right of the corporation (for which a corporation "shall have power to indemnify . . . against the reasonable expenses, including attorneys' fees, actually and reasonably incurred," subject to certain limitations). *Id.*
18. *See* Arnold v. Society for Sav. Bancorp, Inc., 678 A.2d 533, 540 (Del. 1996); *see also* Cochran v. Stifel Financial Corp., 2000 WL 286722, at *12, n.48 (Del. Ch. Mar. 8, 2000).

19. *Arnold*, 678 A.2d at 540, *citing* Radol v. Thomas, 772 F.2d 244, 258-259 (6th Cir. 1985).
20. *Id.* The *Arnold* Court noted that this "discredited notion" was considered and rejected during the drafting of Section 102(b)(7) of the DGCL. To this end, the Court noted: "'Amending Section 145(b) to allow indemnification of judgments or amounts paid in settlement in derivative suits was rejected [by the Corporation Law Section of the Delaware Bar Association] as circular since the corporation would simply be paying itself for injury caused to it by the very directors being indemnified by the corporation. Stockholders would not benefit, and the result would be expensive since the corporation would be saddled with both plaintiff's and defendant's attorney fees.'" *Id.*, at 540, n.18 (*quoting* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.19, at 4-359 (2d ed. 1996)). *See also* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.13[B] (3d ed. 2021 supp.). Other courts have recognized the policy basis for the exclusion from Section 145(b) of indemnification against amounts paid in settlement of derivative claims. In *TLC Beatrice International Holdings, Inc., v. Cigna Insurance* Company, 1999 WL 33454 (S.D.N.Y. Jan. 27, 1999), for example, the US District Court for the Southern District of New York noted that, reading subsections (a) and (b) of Section 145 together, "it is plain that the omission of a power to indemnify in derivative suits was intentional." *Id.* at *5 (*citing* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations and Business Organizations, § 4.22, at 4-84 (3d ed. 1998)). *Citing* to the Delaware Supreme Court's decision in *Arnold,* the *TLC Beatrice* Court noted that "[t]he reason for the distinction between § 145(a) and (b) apparently is that the ultimate plaintiff in a derivative action is the corporation on whose behalf the suit is brought," and observed that allowing the corporation "to indemnify an officer or director for amounts paid in settlement or satisfaction of judgment in a derivative action would permit the management of the corporation to deprive the corporation, as ultimate plaintiff, of the very benefit it is meant to receive." *Id.*
21. *See* Waltuch v. Conticommodity Services, Inc., 88 F.3d 87 (2d Cir. 1996) (applying Delaware law) (discussed below); *cf.* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.12[A] (3d ed. 2020 supp.) ("It could be argued that, since section 145(b) does not expressly prohibit indemnification of judgments or amounts paid in settlement in derivative suits, such indemnification may be provided under the 'nonexclusive' provision of section 145(f). But it would seem that, since subsections (a) and (b) should be read *in pari materia*, the express inclusion of the broader indemnification power in (a) and its exclusion in (b) demonstrates the legislative intent to prohibit indemnification of judgments or amounts paid in settlement in derivative suits.") (footnotes omitted).
22. 8 *Del. C.* § 145(f).
23. *See Waltuch*, 88 F.3d 87.
24. *Id.* "[T]hat is, [Section 145(g)'s] grant of 'power to purchase and maintain insurance' (exercisable regardless of whether the corporation itself would have the power to indemnify the loss directly) is meaningful only because, in some insurable situations, the corporation simply lacks the power to indemnify its directors and officers directly." The Second Circuit's holding in *Waltuch* regarding the proper application of Section 145(f) was adopted in *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 404, n. 93 (Del. Ch. 2008) (*citing* the Second Circuit's holding in *Waltuch* that "a charter provision 'which would require indemnification of [a corporate official] even if he acted in bad faith, is inconsistent with § 145(a) and thus exceeds the scope of a Delaware corporation's power to indemnify'" as authority for the proposition that Delaware corporations do not have the power under Section 145(f) to extend indemnification where the same would be inconsistent with the "good faith" requirement in Section 145(a) of the DGCL) and in *Cochran v. Stifel Financial Corp.*, 2000 WL 286722, at *18, n.75 (Del. Ch. Mar. 8, 2000).
25. 8 *Del. C.* § 145(g).
26. David A. Drexler et al., Delaware Corporate Law & Practice, § 16.08 (2019).
27. *Id.* (noting that the drafters of Section 145(g) believed that D&O insurers "would, in their own self-interest, establish limits upon the available scope of coverage," with the "practical result" being that D&O insurance would "exceed statutory limitations only with

respect to judgments and settlements imposed for duty of care violations"). *See also* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.13[A] (3d ed. 2010 supp.) ("Although underwriters generally refuse to insurer for, or are statutorily precluded from insuring for, intentional wrongs or underwriting criminal wrongs, D&O insurance coverage for amounts paid in settlement of a claim alleging such wrongs seems to be allowable.").

28. *See* Letter from S. Samuel Arsht to Wright Teasdale, March 27, 1967 ("[I]t is the intent and purpose of the last paragraph of the statute (Section 145(g)) to permit a corporation to buy liability insurance for its directors, officers and others and to pay the entire cost of such insurance. . . . I do not know whether the insurance companies will write policies that will cover a director against liability for other than his negligence; but if broader coverage is obtainable, the corporation would be authorized by the proposed Delaware statute to pay the premium."). (Copy on file with the author.)
29. *See* 1 R. Franklin Balotti & Jesse A. Finkelstein, The Delaware Law of Corporations & Business Organizations, § 4.13[A] (3d ed. 2021 supp.) ("One of the problems coincident with a 'captive' D&O insurance company is that it may not result in spreading the risk. Since the spreading of risk is one of the objectives of insurance, reimbursement from a 'captive' insurance company insuring only the parent company might be held not to be 'insurance' but merely indemnification. To the extent that such 'insurance' would purport to cover payments that are not indemnifiable, the validity of the arrangement may be questionable."); David A. Drexler et al., Delaware Corporate Law & Practice, § 16.08 (2021) ("Corporations finding it impossible to obtain D&O insurance through traditional sources have organized captive insurance subsidiaries to provide coverage. In other cases, independent insurers have insisted upon letters of credit supporting undertakings by the corporations purchasing coverage to reimburse the insurer for claims paid. While these devices have been justified by opinions of counsel under separate corporate existence and independent legal[ly?] significant concepts, the courts have not as yet addressed the issue, leaving a modicum of uncertainty as to their validity. Ultimately, questions raised concerning the validity of such actions may rest upon whether what is involved is really 'insurance,' as that term is used (but not defined) in Section 145(g).").
30. N.M. Stat. Ann. § 15-11-4.1(J).
31. NRS 78.752(1). The phrase "other financial arrangements" is defined to include: "(a) The creation of a trust fund. (b) The establishment of a program of self-insurance. (c) The securing of its obligation of indemnification by granting a security interest or other lien on any assets of the corporation. (d) The establishment of a letter of credit, guaranty or surety."
32. NRS 78.752(2).
33. 8 *Del. C.* § 145(g).
34. 8 *Del. C.* § 145(g)(1).
35. S.B. 203, 151st Gen. Assem. (Del. 2022).
36. 8 *Del. C.* § 145(g)(2).
37. 8 *Del. C.* § 145(g)(3).

SEC RULEMAKING

SEC Proposes Rule Amendments Related to Beneficial Ownership Reporting

By Eric Krautheimer, Bob Reeder, Alan Sinsheimer, and Ryan Jolly

On February 10, 2022, the Securities and Exchange Commission (SEC) voted 3 to 1[1] (with Commissioner Peirce dissenting) to propose certain amendments to Regulation 13D-G and Regulation S-T to, among other things, shorten the filing deadlines for beneficial ownership reports on Schedules 13D and 13G, expand the application of Regulation 13D-G to certain cash-settled derivative securities and broaden the circumstances under which persons are treated as a "group."

As proposed, the amendments would:

- Accelerate the filing deadline for Schedule 13D beneficial ownership reports from 10 days to five days and require that amendments be filed within one business day after a material change, and also generally accelerate the filing deadlines for Schedule 13G beneficial ownership reports;
- Expand the application of Regulation 13D-G to cash-settled derivative securities (other than security-based swaps, which are subject to a parallel proposal) if held with a control intent by deeming holders of such derivative securities as beneficial owners of the underlying reference equity securities;
- Add specification as to the circumstances under which two or more persons have formed a "group" that would be subject to beneficial ownership reporting obligations and provide new exemptions to permit such persons to communicate and consult with each other, jointly engage issuers and execute certain cash-settled derivative transactions without being subject to regulation as a group; and
- Directly impact the 10 percent calculation of beneficial ownership for purposes of Section 16 of the Securities Exchange Act of 1934 (Exchange Act).

The SEC is seeking comment from the public on the proposed amendments. Comments are due on the later of 30 days after the proposed amendments are published in the Federal Register and April 11, 2022, which is 60 days after publication on the SEC's website.

Background

Sections 13(d) and 13(g) of the Exchange Act, together with Regulation 13D-G, require investors who beneficially own more than 5 percent of a covered class of securities to publicly report their beneficial ownership on Schedule 13D (for active investors) or Schedule 13G (for passive investors and certain pre-IPO holders). The current deadlines for filing an initial Schedule 13D and Schedule 13G have not been updated since 1968 and 1977, respectively.[2] According to the Release, however, technological advances, including the ability to submit filings electronically through the SEC's EDGAR system, have "led to calls for a reassessment of the 10-day initial filing deadline."[3]

Accordingly, the SEC's proposed amendments are stated to be directed at modernizing the beneficial ownership reporting rules for today's markets by, among other things, shortening the

Eric Krautheimer, **Bob Reeder**, *and* **Alan Sinsheimer** *are partners, and* **Ryan Jolly** *is an associate, of Sullivan & Cromwell LLP.*

Schedule 13D and Schedule 13G reporting deadlines. The proposed changes to the Schedule 13G reporting deadlines also differ based on type of qualifying investor, with "Passive Investors" being subject to significantly shorter deadlines than "Qualified Institutional Investors" and "Exempt Investors" for both initial and amended 13G filings.

The Release uses three categories of Schedule 13G filers:

1. "Qualified Institutional Investors" who are eligible to file a Schedule 13G pursuant to Rule 13d-1(b) and are permitted to file an initial report on Schedule 13G within 45 days after year-end;
2. "Passive Investors" who are eligible to file a Schedule 13G pursuant to Rule 13d-1(c); and
3. "Exempt Investors" who are eligible to file a Schedule 13G pursuant to Rule 13d-1(d) and who acquired their greater than 5% position before the issuer's initial public offering.

For ease of reference, we use the same terms in the same manner in this article.

Sections 13(d) and 13(g) of the Exchange Act also currently provide that when two or more persons act as a group for the purpose of acquiring, holding or disposing of securities of an issuer, such group shall be deemed a single person for the purposes of beneficial ownership reporting. The proposed amendments would significantly alter the current rule and expand the "group" concept.

Section 16 of the Exchange Act subjects greater than 10 percent beneficial owners of an issuer's voting equity securities to reporting obligations, short-swing profit liability and a short sale prohibition. The current rules under Section 16 use the same "beneficial ownership" rules under Section 13(d) for purposes of determining when a person is a greater than 10 percent beneficial owner. As a result, any changes to the beneficial ownership rules under Section 13(d) would also change the manner in which beneficial ownership is calculated for such Section 16 purposes.

Overview of the Proposed Amendments

Accelerated Schedule 13D and 13G Filing Deadlines

The SEC is proposing the following changes to the filing deadlines under Regulation 13D-G:

- Revising (1) the Rule 13d-1(a) filing deadline for an initial Schedule 13D filing to five days after the date on which the person crosses the 5 percent threshold and (2) the Rule 13d-2(a) filing deadline for amendments to Schedule 13D from "promptly" to one business day after the date on which a material change occurs;[4]
- Amending (1) Rules 13d-1(b) and (d) to shorten the deadline for an initial Schedule 13G filing for Qualified Institutional Investors and Exempt Investors to within five business days after the last day of the month in which the 5 percent threshold is crossed and (2) Rules 13d-1(e), (f) and (g) to shorten the filing deadline for an initial Schedule 13D filing by certain persons who forfeit their eligibility to report on Schedule 13G in lieu of Schedule 13D to five days after the event that causes the ineligibility;[5]
- Amending Rule 13d-1(c) to shorten the deadline for Passive Investors to file an initial Schedule 13G to five days after the date on which the person crosses the 5 percent threshold;
- Revising Rule 13d-2(b) to change the filing deadline for amendments to Schedule 13G to five business days after the end of the month in which a *material* change in the information previously reported occurs;[6]
- Amending Rule 13d-2(c) to shorten the filing deadline for Schedule 13G amendments filed by Qualified Institutional Investors and Exempt Investors to five days after the date on which beneficial ownership first exceeds 10 percent of a covered class, and thereafter upon any deviation by more than 5 percent of the covered class, with such requirements applying if the thresholds were crossed at any time during a month; and

- Amending Rule 13d-2(d) to revise the filing deadline for amendments filed by Passive Investors from a "promptly" standard to one business day after the date on which beneficial ownership exceeds 10 percent of a covered class, and thereafter upon any deviation by more than 5 percent of the covered class.

The Release also proposes to amend Rule 13(a) of Regulation S-T to permit Schedule 13D and 13G filings (and any amendments thereto) that are submitted before 10 pm, Eastern time, on a given business day (rather than 5:30 pm, Eastern time, as the rules currently provide) to be deemed to have been filed that same day, which the Release states would help ease filers' administrative burdens. This is the same filing deadline for the filing of Forms 3, 4 and 5 under Section 16 of the Exchange Act. However, the Release also proposes to amend Rule 201(a) of Regulation S-T to remove the opportunity for a Schedule 13D or 13G filer to pursue a temporary hardship exemption under that rule.

Further, the Release proposes to define "business day" (which is currently undefined) for purposes of Regulation 13D-G to mean any day, other than a Saturday, a Sunday, or a Federal Holiday, from 6 am to 10 pm, Eastern time, meaning events that occur prior to 10 pm, Eastern time, on a given day would result in such day counting as day 1. The Release also clarified in a footnote that the current 10-day deadline under Rule 13d-1(a) is measured in calendar days, and that the proposed five-day deadline for initial Schedule 13D filings under the proposed amendments would similarly be measured in calendar days (with the caveat that if the last day of the deadline is not a business day then such filing may be made on the next business day).

A summary of the changes that the SEC is proposing to the Schedule 13D and 13G filing deadlines is set forth in a table on pages 9 and 10 of the proposing release. The table is also attached to this article as Exhibit 1.

Regulation of Derivative Securities

In addition, the proposed amendments add a new paragraph (e) to Rule 13d-3 to deem holders of cash-settled derivative securities as beneficial owners of the reference covered class if the derivative security is held with the purpose or effect of changing or influencing the control of the issuer of the reference securities, or in connection with or as a participant in any transaction having such purpose or effect. Accordingly, the proposed amendment would deem holders of such derivative securities to beneficially own the reference securities just as if they held such securities directly, even if such a holder has no right or agreement to vote or dispose of, or direct the voting or disposition of, the underlying security.

The exclusion of security-based swaps from the proposed rule significantly limits its scope. For example, equity swaps on a single equity security would be excluded from the proposed rule since these instruments are security-based swaps. The SEC has published a separate rule proposal regarding the reporting of security-based swaps.[7]

The proposed amendments incorporate the definition of "derivative security"[8] from the rules under Section 16 of the Exchange Act. This definition of "derivative security" is broad and is used in the Section 16 context to determine whether a reporting person has a "pecuniary interest"[9] in the security subject to Section 16. Using this definition in the proposed rule may pick up baskets of securities where the relevant security makes up as little as 4 percent of the basket.[10] On the other hand, derivative securities with a floating exercise price are excluded from the definition of derivative security. This would be a significant change from the current rules under Section 13(d) and would likely require the implementation of new systems to monitor.

New paragraph (e) would provide that the number of securities that a holder of such derivative security will be deemed to beneficially own will be the *larger* of: (A) to the extent applicable, the product of (x) the number of securities by reference to which the amount payable under the derivative security is determined multiplied by (y) the "delta"[11] of the derivative security;[12] and (B) to the extent applicable, the number obtained by (x) dividing the notional amount of the derivative security by the most recent closing market price of the reference equity security

Exhibit 1

Issue	Current Schedule 13D	Proposed New Schedule 13D	Current Schedule 13G	Proposed New Schedule 13G
Initial Filing Deadline	Within 10 days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	Within five days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	QIIs & Exempt Investors: 45 days after calendar year-end in which beneficial ownership exceeds 5%. Rules 13d-1(b) and (d). Passive Investors: Within 10 days after acquiring beneficial ownership of more than 5%. Rule 13d-1(c).	QIIs & Exempt Investors: Five business days after month-end in which beneficial ownership exceeds 5%. Rules 13d-1(b) and (d). Passive Investors: Within five days after acquiring beneficial ownership of more than 5%. Rule 13d-1(c).
Amendment Triggering Event	Material change in the facts set forth in the previous Schedule 13D. Rule 13d-2(a).	No amendment proposed – material change in the facts set forth in the previous Schedule 13D. Rule 13d-2(a).	All Schedule 13G Filers: Any change in the information previously reported on Schedule 13G. Rule 13d-2(b). QIIs & Passive Investors: Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).	All Schedule 13G Filers: Material change in the information previously reported on Schedule 13G. Rule13d-2(b). QIIs & Passive Investors: No amendment proposed – upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).
Amendment Filing Deadline	Promptly after the triggering event. Rule 13d-2(a).	Within one business day after the triggering event. Rule 13d-2(a).	All Schedule 13G Filers: 45 days after calendar year-end in which any change occurred. Rule 13d-2(b). QIIs: 10 days after month-end in which beneficial ownership exceeded 10% or there was, as of the month-end, a 5% increase or decrease in beneficial ownership. Rule 13d-2(c). Passive Investors: Promptly after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rule 13d-2(d).	All Schedule 13G Filers: Five business days after month-end in which a material change occurred. Rule 13d-2(b). QIIs: Five days after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rule 13d-2(c). Passive Investors: One business day after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rule 13d-2(d).
Filing "Cut-Off" Time	5:30 p.m., Eastern time. Rule 13(a)(2) of Regulation S-T.	10 p.m., Eastern time. Rule 13(a)(4) of Regulation S-T.	All Schedule 13G Filers: 5:30 p.m., Eastern time. Rule 13(a)(2) of Regulation S-T.	All Schedule 13G Filers: 10 p.m., Eastern time. Rule 13(a)(4) of Regulation S-T.

and then (y) multiplying such quotient by the "delta" of the derivative security.[13] The Release notes that clause (A) would only be applicable if the agreement governing the terms of the derivative security provides a way to calculate the number of reference securities on which the amount payable pursuant to that security is based, whereas clause (B) would be applicable to all derivative securities.

The proposed amendments require the calculation under clause (B) to be performed on a *daily* basis for all derivative securities, even those that reference a fixed number of securities. The calculation in clause (A) would be a fixed number so long as the delta did not change. In the case of certain products, such as cash-settled options, the delta may change daily. For these instruments, daily calculations under clauses (A) and (B) would be required. Reporting persons would need to implement policies, procedures and systems to make those daily calculations.

Only long positions in derivative securities would be counted under the proposed rule. As a result, and similar to the SEC's parallel security-based swap position reporting proposal, reporting persons would not be able to offset short cash-settled derivative positions with long cash-settled derivative positions. This gross calculation may result in Schedule 13D filers reporting a higher beneficial ownership percentage than their economic ownership. The Release also proposes to amend Item 6 to Schedule 13D to clarify that a person is required to disclose interests in all security-based swaps and other derivative securities (including cash-settled derivative securities) that use the issuer's equity security as a reference security. The SEC is including security-based swaps in this amendment unlike proposed Rule 13d-3(e).

Group Formation and Related Exemptions

The Release proposes to align Rule 13d-5 with the statutory language in Sections 13(d)(3) and 13(g)(3) of the Exchange Act to remove the potential implication that an express or implied agreement among group members is a necessary precondition to the formation of a group under those provisions of the Exchange Act and, by extension, Regulation 13D-G.

The Release contains an extended discussion of case law that has held that in order to have a "group" there needs to be an "agreement" as to voting, holding, acquiring or disposing of the relevant securities.

The SEC takes the position in the Release that an express or implied "agreement" is not necessary to have a "group." Rather, the SEC indicates that if two or more persons "act as" a group they will be deemed a group. According to the SEC, the "act as" standard encompasses not only agreements in the classic contractual sense but also "pooling arrangements, whether formal or informal, written or unwritten."[14] The scope of this pooling arrangement concept is unclear from the Release, but the SEC indicates "concerted actions by two or more persons for the purpose of acquiring, holding or disposing of securities of an issuer are sufficient to constitute the formation of a group."[15] Taken together, these statements indicate a significant expansion of the group concept.

The proposed amendments further extend the "group" concept to encompass a new "tipper-tippee" provision. The new tipper-tippee provision would provide that if a person, in advance of filing a Schedule 13D, discloses to any other person that such filing will be made (to the extent such information is shared with the purpose of causing such other person to acquire securities in the same covered class) and such other person acquires, based on that information, securities in the same covered class for which the Schedule 13D will be filed, then those persons are deemed to have formed a group within the meaning of Section 13(d)(3).

The SEC justifies this expansion of the group concept on the basis that the tippee may be purchasing at lower prices than would exist if the Schedule 13D had been filed at the time and that the information may be provided by the tipper to "a trusted few." As a result, this proposal seems to be driven more by insider trading type concerns than group concerns.

As a result of the SEC's new view of what constitutes a group and the new tipper-tippee proposed amendment, the SEC proposes two new exceptions to ameliorate the impact of these changes. The SEC indicates:

> Specifically, we are aware that activity exists among shareholders, investors, holders of derivatives and other market participants that may, absent an exemption, implicate Sections 13(d)(3) and 13(g)(3). For example, institutional investors or shareholder proponents may wish to communicate and consult with one another regarding an issuer's performance or certain corporate policy matters involving one or more issuers. Subsequently, those investors and proponents may take similar action with respect to the issuer or its securities, such as engaging directly with the issuer's management or coordinating their voting of shares at the issuer's annual meeting with respect to one or more company or shareholder proposals.[16]

To address this, the SEC proposes new Rule 13d-6(c) under which two or more persons may communicate and consult with one another and engage with an issuer without concern that they will be subject to regulation as a group with respect to the issuer's equity securities.

Specifically, the proposed amendment provides two or more persons will not be a group so long as:

- The communications between or among such persons are not undertaken with the purpose or the effect of changing or influencing control of the issuer, and are not made in connection with or as a participant in any transaction having such purpose or effect; and
- Such persons, when taking such concerted actions, are not obligated to take such actions.

Likewise, the SEC expresses concern about the ability of financial institutions to enter into derivative transactions in the ordinary course of business. The proposed amendments would exclude from the group concept two or more persons who:

- In the ordinary course of business enter into bona fide purchase and sale agreements setting forth the terms of a derivative security; and
- Did not enter into the agreement with the purpose or effect of changing or influencing control of the issuer or in connection with or as a participant in any transaction having such purpose or effect.

If an activist investor enters into a derivative security in connection with its efforts to influence or change control of an issuer, it is unclear whether the activist and its counterparty could qualify for this exemption since the parties may not meet the no influence or control test.

Section 16

The SEC recognizes the proposed amendments will increase filings by greater than 10 percent beneficial owners under Section 16. The SEC estimates Section 16 filings will increase by approximately 10 percent if the proposed amendments are adopted. Nevertheless, the SEC does not propose any changes to the 10 percent beneficial ownership test under Section 16. Instead, the SEC requests comments on the issue of, for example, whether the proposed rule on equity securities underlying cash-settled derivative securities should be excluded from the Section 16 calculation.

Structured Data Requirements for Schedules 13D and 13G

Finally, the proposed amendments would require that Schedules 13D and 13G be filed using a structured, machine-readable data language, meaning all disclosures (including quantitative disclosures, textual narratives and identification checkboxes) on Schedules 13D and 13G would be required to be filed using an XML-based language. According to the Release, this is intended to make it easier for investors and markets to access, compile and analyze information that is disclosed on Schedules 13D and 13G. However, the exhibits to Schedules 13D and 13G would remain unstructured.

Potential Implications

Some potential implications of the proposed amendments include:

- ***Broader Scope of Beneficial Ownership:*** By expanding the meaning of "beneficial owner" to include persons who hold cash-settled derivative securities with a control purpose, the proposed amendments will increase the number of Section 13(d) and 13(g) filers or accelerate the time by which those filers are required to file. The SEC estimates a 5 percent increase in filings from this change. The term "derivative securities" is very broad and could pick up instruments that investors would not expect to convey beneficial ownership under Sections 13(d) and 13(g).
- ***Groups:*** The expanded meaning of "beneficial owner," together with the proposed amendments to Rule 13d-5, including the addition of a new "tipper-tippee" provision, could significantly increase the number of scenarios in which two or more persons are deemed to have formed a group for purposes of both Section 13(d) and Section 16 of the Exchange Act. The SEC estimates a 5 percent increase in Section 13(d) filings as a result of this change. It could become particularly difficult for groups to coordinate in order to timely submit filings in light of the shortened filing deadlines.
- ***Shareholder Activism:*** The Release indicates that in 2020 over 55 percent of Schedule 13D filings were made on the 10th day or later following the filer crossing the 5 percent threshold. Shortening the deadline for initial Schedule 13D filings to five days would therefore have a significant effect in practice. Including certain cash-settled derivative securities in the beneficial ownership calculation would further exacerbate this effect by causing activists to cross the 5 percent threshold sooner. Similarly, there could be a substantial impact on the number of securities that an activist could acquire prior to disclosure. The shorter window would reduce activists' ability to acquire shares at lower, pre-disclosure prices which could reduce the incentives for some activists to initiate campaigns, thereby also reducing shareholder engagement.
- ***Unsolicited M&A Activity:*** The shorter reporting deadlines (including for material amendments), substantially broadened definition of beneficial ownership and expansion of the "group" concept could impact certain M&A transactions by reducing an unsolicited acquirer's ability to acquire exposure to a stock prior to alerting a target company. The proposed amendments may give companies with substantial takeover defenses added protection, including by effectively lowering poison pill thresholds since those thresholds are typically based on beneficial ownership levels as measured under the 13D rules.
- ***Accelerated Filings by Qualified Institutional Investors:*** Under the current reporting rules, a Qualified Institutional Investor typically only has to file a Schedule 13G once a year within 45 days of year-end based on its holdings at year-end. The proposed amendments would significantly change this reporting regime. Not only would Qualified Institutional Investors need to monitor their positions at the end of each month, but they would also need to monitor them on a daily basis to comply with the proposed amendment requirements. While the SEC indicates in the Release that Qualified Institutional Investors should already have policies, procedures and systems in place to determine beneficial ownership, we are uncertain whether those policies, procedures and systems have been designed to operate on a daily basis.
- ***10 Percent Beneficial Ownership for Section 16 Purposes:*** The proposed amendments to Rules 13d-3, 13d-5 and 13d-6 directly impact the 10 percent calculation of beneficial ownership for purposes of Section 16. As a result of the expanded meaning of "beneficial owner" under Section 13(d) of the Exchange Act, the proposed amendments will increase the number of persons subject to Section 16 of the Exchange Act as well, thereby increasing the number of Section 16 filings and the number of holders subject to short-swing profit liability and

short sale prohibitions under Sections 16(b) and 16(c), respectively.

Notes

1. The Commission is currently comprised of only four commissioners following the recent departure of Commissioner Roisman, which was announced in December 2021. *See* Statement of Commissioner Elad L. Roisman (Dec. 20, 2021), available at *https://www.sec.gov/news/statement/roisman-20211220*.
2. Modernization of Beneficial Ownership Reporting. SEC Release Nos. 33-11030 and 34-94211 (Feb. 10, 2022) (Release) at 14 and 32.
3. *Id*. at 15 (footnote omitted).
4. One of the SEC's specific questions in the Release on which it is soliciting comment relates to whether the SEC should use a tiered approach rather than shortening the Schedule 13D deadline in all instances. The SEC asks, for example: "Rather than shorten the deadline under Rule 13d-1(a) in all instances, should we offer a tiered approach, such as maintaining the 10-day deadline for acquisitions of greater than 5 percent but no more than 10 percent while instituting a shorter deadline if beneficial ownership exceeds 10 percent? Should a person who "stands still" (*i.e.*, chooses to make no further acquisitions of beneficial ownership) after crossing the 5 percent threshold be subject to a longer filing deadline than those persons who continue to make acquisitions after crossing the 5 percent threshold?" *Id*. at 25.
5. However, Rule 13d-1(e)(2), which the SEC does not propose to amend, would still prohibit such persons who forfeit their eligibility to report on Schedule 13G as a result of developing a control intent from voting or directing the voting of the covered securities or acquiring an additional beneficial ownership interest in any equity securities of the issuer or any person controlling the issuer until the expiration of *10 days* from the date of the Schedule 13D filing.
6. Instead of the current annual amendment obligation arising for Schedule 13G filers upon the occurrence of "any change" in the facts previously reported regardless of the materiality of such change, the Release also proposes to revise Rule 13d-2(b) to require that an amendment to a Schedule 13G be filed only if a "material change" occurs.
7. *See* our Sullivan & Cromwell memo (Dec. 29, 2021), available at *sc-publication-SEC-proposes-rules-security-based-swaps.pdf* (sullcrom.com). The SEC is limited in its ability to deem a security-based swap to confer beneficial ownership of an underlying security because Section 13(o) of the Exchange Act provides that the SEC, after consultation with the Secretary of the Treasury and the bank prudential regulators, may determine, if necessary to achieve the purposes of Section 13(o), that security-based swaps provide incidents of ownership comparable to direct ownership of the underlying securities. According to the SEC, the same limitation does not apply to other derivative securities.
8. Rule 16a-1(c) under the Exchange Act defines "derivative securities," with certain exceptions, as "any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security."
9. Rule 16a-1(a)(2)(i) under the Exchange Act defines "pecuniary interest" as "the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities."
10. *See* SEC No-Action Letter, Goldman Sachs & Co. (Oct. 14, 1997) (Ownership of a basket of equity securities does not represent a pecuniary interest in a security included in the basket for Section 16 purposes if such security makes up 3 percent or less of the market value of all of the equity securities in the basket).
11. Proposed paragraph (e)(2)(ii) of Rule 13d-3 would define "delta" to mean, with respect to a derivative security, the ratio that is obtained by comparing (x) the change in the value of the derivative security to (y) the change in the value of the reference equity security. The Release also notes that if a derivative security does not have a fixed delta (i.e., if the delta is variable and changes over the term of the derivative security), then a person who holds such derivative security should calculate the delta on a daily basis for purposes of determining the number of equity securities that such person will be deemed to

beneficially own, based on the closing market price of the reference equity security on that day.

12. The Release provides in a footnote the following illustration of the application of the proposed rule in clause (A): A holder of a derivative security with a delta equal to one that references 100 shares of a covered class of common stock would be deemed to beneficially own 100 shares of such covered class. If, however, that derivative security had a delta equal to two, then such holder would be deemed to beneficially own 200 shares of such covered class, calculated as (x) the 100 shares of common stock referenced by the derivative security multiplied by (y) the derivative security's delta of two. Release at 63, n.106.
13. The Release provides in a footnote the following illustration of the application of the proposed rule in clause (B): If a person holds a derivative security with a notional amount of $100 and a delta equal to one that references a covered class of common stock with a most recent closing market price of $10 per share, then that person would be deemed to beneficially own 10 shares of such covered class. If, however, that same derivative security had a delta equal to two, then such person would be deemed to beneficially own 20 shares of such covered class, calculated as (x) the quotient obtained by dividing the $100 notional amount of the derivative security by the $10 per share most recent closing market price, (y) multiplied by the derivative security's delta of two and, unlike clause (A), which will in general only change when the delta changes, will change every day if the price of the reference security changes. *Id*. at 63-64, n.107.
14. *Id*. at 80.
15. *Id*. at 82.
16. *Id*. at 95.

The SEC Revises Its Filing Fee Framework

By Sean Donahue, John Newell, Folake Ayoola, James Hammons, Jr., Lauren Visek, and Jacqueline Kaufman

Recent amendments adopted by the Securities and Exchange Commission (SEC) have changed a variety of SEC rules, forms and schedules related to disclosure and payment of SEC filing fees. The most visible changes for most filings will be (1) replacing the current fee table on the cover page and in the EDGAR submission header of most fee-bearing SEC filings with new fee table exhibits and (2) changes in fee payment methods.

The amendments will improve and expedite SEC review of filing fee calculations. The new methods for payment of filing fees will provide filers with more flexibility, but will also require companies to consider how their choice of fee payment methods may affect timely fee payment in order to avoid the consequences of late fee payments.

Sean Donahue, John Newell, Folake Ayoola, James Hammons, Jr., Lauren Visek, *and* **Jacqueline Kaufman** *are attorneys of Goodwin Procter LLP.*

The amended rules, forms and schedules that implement the new fee table exhibits became effective on January 31, 2022. The amended fee payment rules will become effective on May 31, 2022. The Interactive XBRL tagging requirements for fee table exhibits will become effective on July 31, 2024 (large accelerated filers) and July 31, 2025 (all other filers).

Practical Considerations

Two areas of focus under the prior SEC filing fee regime will continue to require attention. First, fee offsets and carryforwards should be reviewed and calculated with care because the basis and calculation of fee offsets will be more transparent and more easily reviewed by the SEC. Second, although the amendments will update permitted fee payment methods to include automated clearing house (ACH) transfers and payments by debit cards and credit cards, subject to a variety of conditions discussed below, in most cases the new fee payment methods will not be processed immediately and some may involve delays of one to three business days before funds are available to the SEC for fee payments.

These delays may increase the potential for untimely payment of SEC registration fees. In addition, companies may need to consider other limitations on the new fee payment methods, such as a $25,000 daily and per-filing-fee limit on credit card payments. The amendments do not significantly change the risks in either of these areas, but are likely to make inadvertent errors more visible.

Amended Forms and Schedules

The amendments affect the following filings under the Securities Act of 1933: Form S-1, Form S-3, Form S-4, Form S-8, Form S-11, Form F-1, Form F-3 and Form F-10. The amendments also affect the following schedules filed under the Securities Exchange Act of 1934: Schedule 13E-3, Schedule 13E-4F, Schedule 14A, Schedule 14C, Schedule TO and Schedule 14D-1F. These amendments became effective January 31, 2022.

Filing Fee Information Disclosure

Fee Table Exhibits

The amendments implement a system of filing fee tables that will be filed as exhibits, replacing the filing fee table and information on the cover page and in the EDGAR submission header of most SEC fee-bearing filings. The new exhibit requirement and the related instructions are set forth in Item 601(b)(107) of Regulation S-K and the relevant SEC forms and schedules. The amendments to Form S-1 and Form S-3, for example, include three tables. "Table 1: Newly Registered and Carry Forward Securities," applies to all Form S-1 and Form S-3 filings.

If applicable, these filings should also include "Table 2: Fee Offset Claims and Sources," which provides information about fee offsets applied to the filing fee, and "Table 3: Combined Prospectuses," which provides additional information for filings that rely on Rule 429. Blank forms of Table 1 and Table 2 for Form S-1 filings are shown at the end of this article. The fee table exhibits and amendments to SEC forms and schedules vary somewhat, depending on the form or schedule being filed. The fee table exhibit and related form and schedule amendments became effective on January 31, 2022.

XBRL Tagging Requirement

The amendments will require companies to file the fee calculation information in "structured" format, meaning that the data must be tagged using Inline XBRL as required by Item 408 of Regulation S-T. Large accelerated filers must comply with this requirement for filings made on or after July 31, 2024. All other filers must comply this requirement for filings made on or after July 31, 2025.

Accepted Fee Payment Methods

The amendments eliminate paper checks and money orders as accepted methods for payment of SEC filing fees. The SEC will continue to accept payment of filing fees by wire transfer. In addition to wire transfers, the amendments permit companies to pay filing fees by ACH transfers and by debit or credit cards issued by US financial institutions, subject to certain limitations. The fee payment method amendments will be effective on May 31, 2022.

Filers should be aware that none of these payment methods is instantaneous, and filing fees are not considered paid until the SEC has received the funds. Because some fee payment methods may result in delays of up to three business days in payment of filing fees, the SEC advises in the adopting release that "filers should time their payments and filings accordingly." Timing considerations for fee payments include the following:

- Wire transfers are generally (but not always) available on a same-business-day basis, but companies incur fees for wire transfers;

- ACH transfers may be made through the banking system or through the US Treasury's Pay.gov system. Domestic ACH transfers involving amounts of $100,000 or less are eligible for same-day settlement if made through the banking system, but companies incur fees for these ACH transfers. Pay.gov will not require processing fees for ACH payments, but ACH transfers through Pay.gov are expected to require one to three business days for settlement and availability to the SEC for filing fee payments; and
- The SEC expects that debit card payments will not be available until the next business day. The SEC expects that credit card payments may take up to 24 hours following the transaction to be available. Pay.gov is not expected to charge fees for processing debit card and credit card payments, but issuers of debit cards and credit cards may charge fees on these transactions. Pay.gov currently supports Visa and MasterCard debit cards and Visa, MasterCard, American Express and Discover-branded credit cards that have been issued by a U.S. financial institution. Credit card payments will be subject to a daily and per-filing-fee limit of $25,000.

Filing Fee Offsets

The amendments change certain fee offset rules and include a new table that provides additional information about fee offset sources, uses and calculations.

The most substantive change permits a company that wishes to increase the registered amount of one or more classes of securities on a registration statement and decrease the amount registered of one or more other classes on the same registration statement to file a pre-effective amendment that calculates the total filing fee due based on the then-current expected offering amounts, offering prices, and filing fee rates and rely on Rule 457(b) to apply the amounts previously paid in connection with the registration statement as a credit against the current total filing fee due, provided that the company did not rely on Rule 457(o) to calculate the original filing fee.

This filing fee offset procedure is available only if the company concurrently seeks to increase the amount of one or more classes or add one or more classes and decrease the amount of one or more other classes, but will not be available in situations where a company seeks only to decrease or only to increase the amount of any class of registered securities, or only to add a class of securities to the registration statement.

The amendments also clarify, consolidate and conform a variety of rules and instructions related to filing fee offsets and other filing fee matters. This includes Rule 415(a)(6) and related instructions in Form S-3, which permits companies to carry forward previously registered but unsold securities to a new registration statement, and to apply the filing fee previously paid for the unsold securities to the new registration statement.

Sample Fee Tables: Table 1 and Table 2 (Form S-1)

Item 601(b)(107) sets forth the requirements and instructions for the new fee table exhibits, which are specific to individual forms and schedules. The SEC also amended the relevant forms and schedules. The following examples show the tables for newly registered and carry forward securities (Table 1) and filing fee offset claims and sources (Table 2) for a Form S-1 registration statement.

Table 1—Newly Registered and Carry Forward Securities (Form S-1)

	Security Type	Security Class Title	Fee Calculation or Carry Forward Rule	Amount Registered	Proposed Maximum Offering Price Per Unit	Maximum Aggregate Offering Price	Fee Rate	Amount of Registration Fee	Carry Forward Form Type	Carry Forward File Number	Carry Forward Initial effective date	Filing Fee Previously Paid In Connection with Unsold Securities to be Carried Forward
Newly Registered Securities												
Fees to Be Paid	X	X	X	X	X	X	X	X				
Fees Previously Paid	X	X	X	X	X	X		X				
Carry Forward Securities												
Carry Forward Securities	X	X	X	X		X			X	X	X	X
Total Offering Amounts						X		X				
Total Fees Previously Paid								X				
Total Fee Offsets								X				
Net Fee Due								X				

Table 2—Fee Offset Claims and Sources (Form S-1)

	Registrant or Filer Name	Form or Filing Type	File Number	Initial Filing Date	Filing Date	Fee Offset Claimed	Security Type Associated with Fee Offset Claimed	Security Title Associated with Fee Offset Claimed	Unsold Securities Associated with Fee Offset Claimed	Unsold Aggregate Offering Amount Associated with Fee Offset Claimed	Fee Paid with Fee Offset Source
Rule 457(b) and 0-11(a)(2)											
Fee Offset Claims		X	X	X		X					
Fee Offset Sources	X	X	X		X						X
Rule 457(p)											
Fee Offset Claims	X	X	X	X		X	X	X	X	X	
Fee Offset Sources	X	X	X		X						X

SEC ENFORCEMENT

SEC's New Insider "Shadow Trading" Theory Survives Its First Test

By Jay Dubow, Seth Erickson, and Ghillaine Reid

The Securities and Exchange Commission (SEC) is testing the bounds of insider trading laws, and it recently survived the first challenge to its newest theory. On January 14, the US District Court for the Northern District of California issued a decision in *SEC v. Panuwat*,[1] supporting the SEC's legal theory that "shadow trading" can violate securities law(s). "Shadow trading" is a phrase that refers to the practice in which corporate insiders use confidential nonpublic information to facilitate trading in economically linked firms in an effort to avoid insider trading laws.[2]

SEC v. Panuwat

In *Panuwat*, the SEC alleged that Matthew Panuwat was a senior director at Medivation, Inc. — a "mid-cap, oncology-focused biopharmaceutical company." Panuwat's job responsibilities included working closely with other executives and with investment bankers to explore Medivation's options for merging with another company. Minutes after Medivation's CEO advised Panuwat and other executives that Pfizer, Inc., wanted to acquire Medivation, Panuwat purchased call options in a company called Incyte, Inc., which Panuwat previously identified for the investment bankers as one of Medivation's close peer companies.

After announcing the Medivation-Pfizer merger, Medivation's share price jumped 20 percent, and other mid-cap biopharmaceutical companies' share prices also increased, including Incyte's. As a result of his call options, Panuwat earned $107,666 in profits. On August 17, 2021, the SEC brought suit, alleging that Panuwat violated Section 10(b) of the Exchange Act and Rule 10b-5 by purchasing Incyte options after learning of Medivation's likely merger with Pfizer.

Panuwat's Motion to Dismiss

Panuwat moved to dismiss the SEC's lawsuit and asserted that the complaint failed to adequately plead: (1) that the information at issue was material and nonpublic; (2) that Panuwat breached his duty to Medivation; and (3) that Panuwat acted with scienter. Panuwat also asserted that the SEC's novel theory improperly seeks to expand securities laws and would violate Panuwat's due process rights.

The court rejected each of these arguments. The court found that the broad language of the securities laws allows for insider information of one company to be material to more than one company, reasoning that the laws broadly prohibit insider trading of "*any* security" using "*any* manipulative or deceptive device." The court noted that nothing in the laws provide that information "about that security or issuer" must come from the same security or issuer itself to be material.

The court also rejected Panuwat's argument that he did not breach his duty to Medivation by trading in Incyte's securities. The court explained that Medivation's *own* insider trading policy broadly prohibited trading in "securities of another publicly traded company," which included Incyte. The court also found that the SEC had sufficiently alleged that

Jay Dubow, Seth Erickson, *and* **Ghillaine Reid** *are partners of Troutman Pepper LLP.*

Panuwat acted with scienter because the allegations in the complaint—that Panuwat purchased Incyte's stock within minutes of receiving the email indicating that a deal with Pfizer was imminent—was sufficient circumstantial evidence to indicate that Panuwat acted with the requisite scienter.

Finally, the court rejected Panuwat's argument that the SEC's claim—"that confidential information regarding an acquisition involving Company A should also be considered material to Company B (and presumably companies C, D, E, etc.) that operate within the same general industry"—stretches the misappropriation theory beyond what comports with due process.

While the court acknowledged that the SEC's lawsuit is pursuing a first-of-its-kind theory, the court found that the expansive language of Section 10(b) allowed for such an action. The court reasoned that the scope of the law was not limitless, but instead that "scienter and materiality provide sufficient guardrails to insider trading liability."

Takeaways

The *Panuwat* decision is limited to the facts before the court—a uniquely situated employee who used material nonpublic information about his employer to profit from trading in a peer company's securities in a niche market—and was merely the denial of a motion to dismiss.

However, the court's analysis and reasoning also can be seen as judicial support for an expansive interpretation of Section 10b and Rule 10b-5 that could extend to other instances of "shadow trading." Companies and individuals will need to carefully consider the extent to which the *Panuwat* analysis could apply to other facts and whether their insider trading policies should be revised in light of *Panuwat*.

The outcome of *Panuwat* will likely dictate whether courts will be asked to further identify what constitutes impermissible "shadow trading," but a slight variation of the facts could have drastically changed the outcome in this case: What if Panuwat had purchased securities in one of Medivation's suppliers or customers that would have been affected by the merger, or purchased securities in a large- or small-cap "oncology-focused biopharmaceutical company," or bought shares in a fund with holdings comprised of oncology-focused biopharmaceutical companies that were not all close competitors of Medivation? Expect courts to contend with defining the scope of shadow trading if the SEC's *Panuwat* test case succeeds.

Alternatively, given that the court supported its decision by relying on Medivation's own insider trading policy, what if Medivation had a narrower policy that did not mention other companies or if it had no insider trading policy? In such cases, could the SEC pursue a case? It seems that such a theory of liability that depends on the language of an employer's insider trading policy to be unequal, unfair, and unsustainable will be a focus as this continues to be judicially reviewed.

Notes

1. Sec v. Panuwat, No. 3:21-cv-06322-WHO (N.D. Cal.).
2. *See* Mehta, Reeb, and Zhao, "Shadow Trading," 96 Account. Rev. 367 (2021), available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3689154*.

ATTORNEY-CLIENT PRIVILEGE

Emails, Boardrooms and Attorney-Client Privilege

By Adam J. Epstein

In each of the 10 years my firm has been in existence, I've witnessed a disastrous boardroom situation. All of them had three things in common: (1) email; (2) impaired reputations; and (3) they were completely avoidable.

Email has been around for a long time, so you'd think that smart, seasoned executives wouldn't misuse it. You'd be wrong. Almost every CEO, CFO, and board member I've come across doesn't know at least one of the following and has paid—or will pay—the price for it.

Attorney-Client Privilege Part 1

Copying your emails to counsel does not (read: **DOES NOT**) guarantee that the email you just sent to your board colleagues is privileged, unless you are seeking legal advice from counsel in that email.

Attorney-Client Privilege Part 2

Even if you request legal advice in an email to a board colleague and counsel, that email also won't be privileged if you copy a third-party. That is, it's called "Attorney-Client Privilege" not "Attorney-Client-Intern at your PR Firm Privilege" for a reason. For what it's worth, I see this monthly, and rarely do corporate lawyers take their clients to task for it.

You're Asking the Wrong Lawyer

There are loads of otherwise high-quality corporate attorneys who don't know a lot more about attorney-client privilege than you do. Sorry, but as a former large firm lawyer and in-house counsel, I've seen it with my own eyes. If you'd like a lawyer to advise your management team or board about privilege, which I strongly encourage you to do, ask a litigator.

Takeaways

Considering that there are lawyers who don't even understand attorney-client privilege, the best rule of thumb for board members is to use email for scheduling and logistics and use the phone for…everything else. The same rule applies to texts.

If you're unconvinced, I'll introduce you to some board members who lost months of their lives being deposed by plaintiff's attorneys, by the Justice Department, and/or by the SEC for sending emails and texts that simply sounded incriminating but weren't.

If you're still unconvinced, at least do this: prior to sending any substantive email or text to a board colleague, read it out loud while imagining that it's going to be printed in a *New York Times* story subsequent to your company announcing an accounting restatement.

In much the same way that people tend to buy great security systems after their houses are burgled, it's instructive that the executives I referenced, who spent some quality time with the US government, no longer send substantive texts or emails to board colleagues…ever.

Adam J. Epstein *is the founder of Third Creek Advisors, LLC and author of* The Perfect Corporate Board *(McGraw Hill, 2012).*

LAW FIRMS

Law Firm Marketing: Yesterday and Today

By Paula Zirinsky

The marketing behind law firms, and lawyers, has definitely evolved. In "New Partner in the Firm: The Marketing Director," the former president of the National Association of Law Firm Marketing Administrators (the precursor to today's "Legal Marketing Association") noted that in 1984, she was one of five marketing directors in the world and that by 1989, several hundred or so law firms had hired their own marketing directors.[1]

This was not without resistance and challenges, however. As the article notes, organized marketing programs encountered the most resistance from veteran lawyers, who tended to view salesmanship as unprofessional, many calling marketing demeaning. I will say that even when I joined my first law firm in 2001, there were some veteran lawyers who still shared that point of view.

Even what we now view as the most basic tools of the marketer's trade—providing pitch assistance and materials—were debated. *The New York Times* article notes how in the late 1980s, Cooley Godward Castro Huddelson & Tatum (*aka* Cooley Godward, at that time), had its 150 lawyers trained on video camera (how progressive they were…), "with an eye toward helping them refine their pitch to potential clients." Yet even at Cooley Godward, marketing's custom-made information packets on their clients made on "a fleet of desktop computers" were seen as just an internal tool, because "when materials become the focus, the marketing process is less professional."

Paula Zirinsky *is an accomplished chief marketing, communications, and strategy officer, now consulting as a professional services marketing advisor as Paula Zirinsky LLC. She can be reached at paulazirinsky@gmail.com.*

Full swing to 2022 and the Legal Marketing Association now counts 4100+ members across the United States, Canada, and 30 other countries with multiple memberships in nearly all of the AmLaw 200. Yes, times have changed—with the professionalism of the marketing teams ramping up from ill-trained paralegals and secretaries to MBAs and JDs alike.

What also has greatly expanded over the years are law firm branding efforts. Law firms as brands now share equal footing with the marketing efforts of their lawyers, practices, and offices. And leading the way in these efforts: law firm websites, although also a relatively new invention.

In 2012, Bob Ambrogi did a bit of research to determine which firm was the first to have one—noting a Wikipedia entry about now-defunct Heller Ehrman LLP launching the first law firm website in 1994. Also in 1994, *The Baltimore Sun* wrote in "Lawyers in Cyberspace" that Venable, Baetjer, Howard & Civiletti (*aka* Venable) had, "… recently hung out an electronic shingle as a publisher under its own name on the Internet."

For those of us who have been around law firms for some time, the simplicity (I am being kind) of the earlier websites have now been replaced by an ever-changing sophistication heavily focused on the client experience. It is not just about the website however, there has been a huge shift in recognizing the mission, vision, and purpose of the law firm as a brand, with the website as the primary 'carrier' of the brand.

The debate about whether a client hires a law firm, or a lawyer is still a hot one. But clearly, years back, lawyers who wanted to build a practice made the time to try to meet as many people as possible, with the expectation that business would flow in or be referred back to them. Their traditional efforts to sell services (but please do not use that word) included a mix of breakfast, lunch, and dinner sprinkled with legal articles and client and friend's letters. And for many, particularly personable rainmakers, this was the case. It worked.

Back to today, marketing and business development efforts have greatly expanded to include many more lawyers—not just those who enjoyed the one-to-one interactions—supported by a wider assortment of thought leadership opportunities and digital platforms, many heavily data dependent. Legal marketers are engaged daily in efforts to see where business is coming from, how to enhance client engagement, how to aggregate disparate data points from around the firm making it actionable intelligence, all to help generate revenue. All of which is anything but demeaning.

Another interesting footnote: Ross Fishman noted in "A Personal View of Legal Marketing's Long Strange Journey," that in 1990, Winston & Strawn hired its public relations consultant to be the nation's first full-time marketing partner, who in turn hired a half-dozen in-house marketers creating what may have been the first law firm marketing department, one that incidentally included Mr. Fishman.[2] Admirably, Winston & Strawn has come a long way since then. I was recently on a panel with the firm's data scientist, a JD/MBA, who heads their data science, artificial intelligence, and machine learning capabilities. Huge wow to them.

While data-based programs are growing, some more basic tactics remain the same. Marketers are still advising lawyers who want to 'make their mark' to try to 'be known for something.' And to 'sell' their unique/targeted expertise both outside the firm, to attract new clients, as well as inside the firm, toward lawyers across all offices and practices for cross selling opportunities.

And to do this, just as in the 1990s, they typically start with thought leadership, be it yesterday's bylined articles, last decade's blog posts, or in today's digital driven world, webinars and podcasts—all content authored by a lawyer in a format that they can control. Legal marketers are still advising these lawyers to get involved with relevant associations and local organizations by joining, attending events and, even better, joining committees in order to assume a leadership position within the group, knowing that when worked correctly, these networking efforts help to get them connected to other lawyers (who can refer back to them) as well as potential clients. Whether live, or virtual due to the pandemic, the strategies remain the same across practice areas.

But behind the scenes, legal marketers are busy at work via social media and digital marketing strategies and tactics. Enhanced with and by the analysis of data, digital platforms enable the lawyer's words, whether written, heard, or seen, and the firm's branded messages to reach targeted audiences beyond yesterday's 'rolodex' or today's CRM database. From paid campaigns on LinkedIn and Google to lead generation and retargeting, prospects and targets are getting into the—please do not use that word—"sales" funnel. And you know something, it is not demeaning, it is actually quite exciting.

Notes

1. *The New York Times*, June 2, 1989.
2. *ABA Law Practice*, October/November 2005.

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