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KODAK RELEASES SPECIAL COMMITTEE REPORT – DETAILS FAILURES IN CORPORATE GOVERNANCE PRACTICES

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We previously blogged about the myriad issues arising in connection with the botched announcement by Kodak of a potential $765 million loan from the federal government as part of its coronavirus response measures, as well as insider stock transactions preceding and immediately following the announcement. Kodak's board formed a special committee to conduct an internal investigation. Akin Gump, retained by the special committee to conduct the investigation, last week delivered its report of over 70 pages of factual findings and legal analysis, concluding that there were no violations of law or company policy, but identifying corporate governance issues requiring attention and remediation. The company has posted the report on its website.

As we previously blogged, on July 27 the internal public relations team at Kodak released an alert to local media that Kodak would be making a big announcement the following day concerning a major initiative between Kodak and the federal government. Stories immediately started circulating on social media and the websites of local network affiliates. Kodak then contacted the recipients of the advisory to tell them it was meant only as background and was not intended for publication. The formal announcement followed before the market open on July 28 when Kodak and the U.S. International Development Finance Corp (DFC) jointly announced a "letter of interest" contemplating a $765 million loan to Kodak to launch a new pharmaceutical business. Although the press release made clear that this was only a letter of interest and the loan was subject to further diligence by the government as well as satisfaction of some significant conditions, in a television interview the following morning, CEO James Continenza stated that he was "very comfortable" that investors could "bank on it" getting funded. Also on July 29, the company caused a series of Form 4s to be filed revealing significant stock option grants had been made to the CEO and other executives on July 27 prior to disclosure of the potential loan. Over a several day period, Kodak stock volumes soared to 20 times normal trading levels and the stock price rose as high as $60 per share from about $2 per share the prior week. The day following the announcement, as the share price was dramatically rising, a board member gifted 3 million shares of Kodak to a charitable foundation he founded. With the then inflated market value of the stock, the gift was worth a reported $116 million.

While the report concludes there was no wrongdoing, it observes that the company and its officers and directors "could have significantly benefited from adherence to more robust corporate governance standards." The report goes on to enumerate recommendations including –

- Expand the in-house legal department and provide sufficient resources to serve its function; in consultation with outside counsel, review and refresh all policies and procedures, in particular those relating to insider trading, option grant processes and processes for managing contact with the media and other third parties relating to public announcements; and coordinate the Kodak's legal function and compliance function to ensure complete ownership of all such internal policies and procedures;

- With respect to the board and the compensation committee, review and update policies and procedures related to executive compensation, adopting more robust written practices and ensuring committee members receive comprehensive information about proposed executive compensation matters in advance of all committee meetings; and standardize the process for onboarding board and committee members with appropriate training and regularly refresh training;

- Revise the insider trading policy to apply equally to all directors and officers and employees who may become temporary insiders, to have clarity around the pre-clearance process for trades by such insiders, to update and clarify the process for closing the trading window, and to expand the pre-clearance process to apply to proposed gifts of shares, prohibiting such gifts during closed window periods; and

- Review and update the policies and procedures for releasing potentially material non-pubic information and ensure that the public relations department is properly staffed and trained in handling public company public statements.

After its nearly six-week investigation, Akin Gump concluded that none of the company, its officers or directors violated securities laws or the company's own internal policies or procedures and there was no breach of fiduciary duties in connection with the July 27 option grants. The report states that the investigation involved the review of over 60,000 electronic communications and over 40 interviews and included relevant research and analysis of pertinent laws and regulations. The firm stated that it had not undertaken an analysis of the director's 3 million share stock gift under federal tax laws, nor does the report consider some of the public statements by the CEO on the day following the formal announcement.

With respect to the blown advisory issuance on July 27, the report found that the public relations related to the announcement was driven almost exclusively by the DFC and that the July 27 advisory was crafted by the DFC and included the header "for planning purposes only." Kodak was responsible for issuing the advisory to the local media while the DFC was responsible for issuing it to the national media. The report states that "a relatively junior Kodak public relations employee" emailed the advisory to the local media on the morning of July 27 after deleting "for planning purpose only" and inserting "for immediate release," apparently believing that the "planning purposes" header meant that it was the internal draft that she needed to finalize before issuing by adding the "for immediate release" language. Akin Gump concluded there was no violation of Regulation FD because Regulation FD does not apply to media disclosures and, even if it did, the release was unintentional and, once the mistake was discovered, the timeline for issuance of the press release was moved to before the open of market on July 28, clearly within the 24 hour period required under Regulation FD for correcting an inadvertent disclosure.

As to stock purchases by the CEO and a non-executive board member in June, the report found that both executives properly obtained pre-clearance for such purchases as required by Kodak's insider trading policy and such pre-clearance was appropriate given the highly speculative nature of the possible government loan at that time.

Akin Gump concluded that the July 27 option grants were made in accordance with the company's equity plan and had been in the works for months for "legitimate business purposes not related to the DFC loan." Although the report found that there were shortcomings in the process – including a failure to consider the consequences of granting what could look like spring-loaded options and to consider the provisions of the company's executive compensation policy related to the "timing of public announcements" – the grants did not violate the securities laws or the company's policies or plan and did not amount to a breach of fiduciary duty.

In addressing the director's stock gift on the day after the DFC announcement, Akin Gump concluded that the gift did not violate the securities laws because a bona fide gift of shares does not constitute a sale of securities for insider trading purposes. Akin Gump concluded that the gift did not violate Kodak's insider trading policy because although it was made during a closed window period and without pre-clearance by the general counsel, apparently this director had not yet been added to the "insider list" as contemplated by the insider trading policy and so, technically, the pre-clearance requirement did not apply to him and, even if it had, the policy did not clearly prohibit gifts during a closed window period.

The special committee made an additional recommendation to the board. It noted that the composition of the board reflected representation of major shareholders who may no longer own such significant blocks of shares as a result of events following the July 28 announcement. The special committee suggested that the board consider changes in board membership to better align the board with its current shareholders and the strategic direction of the company, including in respect of its plans to expand into pharmaceutical chemical manufacturing.

After release of this report, the stock price again jumped. This despite repeated statements in the report about the "insanity" of the market's response to the July 28 announcement and a general consensus among the executives, directors, and outside experts interviewed by Akin Gump that the extraordinary stock price run-up was way out of line with the announcement of a mere letter of interest subject to significant pre-conditions that Kodak may or may not be able to meet. There is no word about the status of the various government inquiries into this situation which arose in the days and weeks following the announcement, nor has the company or DFC announced any further movement of the loan application. And the various shareholder suits against Kodak and its directors and officers are still out there. So it remains to be seen whether this report will clear the way for Kodak in any meaningful way. What is clear is that Kodak has a lot of work ahead of it to better align its people, policies and procedures to the rigors of being a public company.

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