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The Informed Board

Spring 2021

What questions do prospective SPAC directors need to ask? What are the 10 most common misconceptions regarding attorney-client privilege?

The Informed Board aims to provide insights into the key issues directors face today. We flag potential challenges, explain trends and provide directors with practical advice — without the usual legal jargon.

Welcome to our second issue. We look forward to continuing our discussions with you.

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What Am I Getting Myself Into? Five Questions Prospective SPAC Directors Should Ask

The responsibilities, potential conflicts and risks of serving on a SPAC board differ from those of most other public companies.

With 247 special purpose acquisition companies (SPACs) going public in 2020 and another 298 in the first quarter of 2021, SPAC sponsors have knocked on many doors to find directors.

If you are invited to join a SPAC board, what questions should you ask?

What will be required of me?

SPAC directors owe the same fiduciary duties of care and loyalty as directors of other public operating companies subject to the same governing law. The SPAC board's primary function is overseeing the selection of an operating business with which the SPAC can merge and ensuring full disclosure to the SPAC shareholders about the proposed business combination. However, because there are no operations to monitor, the responsibilities of directors and their time commitment are usually light until the board begins considering targets.

As SPAC management evaluates targets for a potential business combination (known as a "de-SPAC" transaction) over the two-year life of the SPAC, directors receive regular updates and are actively involved in reviewing proposed transactions. The cadence accelerates when a target is identified, and directors often have to adapt to fast-moving transaction timelines, with meetings scheduled on short notice and important and complex information about potential transactions that must be reviewed quickly and carefully. Directors should not expect to receive an investment bank's fairness opinion for a SPAC business combination, absent special circumstances, such as a conflict with the sponsor.

Practical note: If a potential SPAC director's employer is concerned that the SPAC will demand a great deal of its directors' time, the candidate can explain that the workload is typically lighter than that of most public company boards, and the commitment is no longer than two years.

How can I judge whether any given SPAC is a "good SPAC"?

There may be a temptation to think all SPACs are created equal apart from their size and industry focus, but SPACs vary, including as to the quality of their sponsors, their jurisdiction of formation and their ability to indemnify directors.

A SPAC is only as good as its sponsor, and those differ considerably in sophistication, experience and reputation, so researching the sponsor is crucial. Potential SPAC directors should also consider the backgrounds of their fellow directors and whether they have the experience and commitment required to oversee the SPAC.

Roughly 80% of SPACs are formed in the Cayman Islands, where corporate law may be more deferential to directors than Delaware law. To date, there has been no Cayman litigation alleging breach of fiduciary duties by SPAC directors.

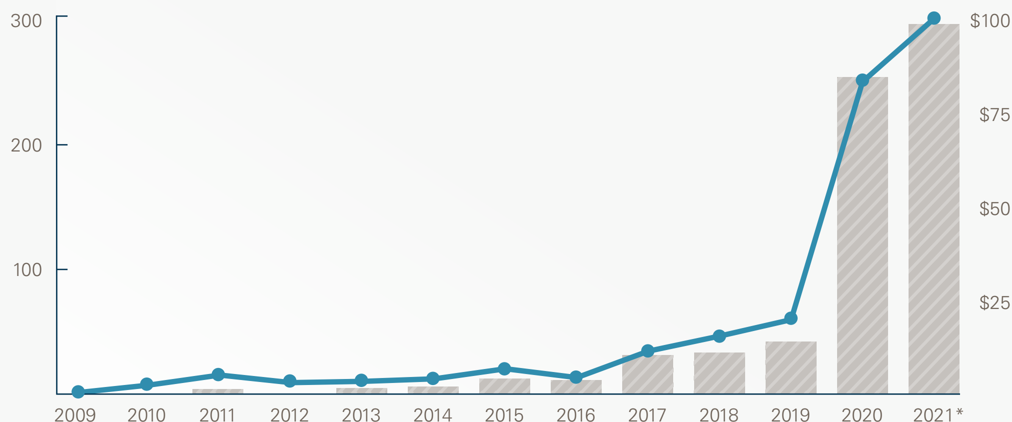
Although nearly all of the lawsuits involving Delaware SPACs have asserted only disclosure-based claims against the SPAC (rather than the directors), we expect that directors will be named as defendants more often in future litigation. One case filed in Delaware, *Amo v. MultiPlan*, alleges that directors breached their fiduciary duties merely by approving a business combination with common SPAC traits. The plaintiffs allege, among other things, that there were "strong (indeed, overriding) incentives to get a deal done — any deal — without regard to whether it is truly in the best interest of the SPAC's outside investors (*i.e.*, whether the target private company is actually a good investment)." This case should be watched closely by any director or prospective director of a Delaware SPAC.

Newly Formed SPACs Have Created Demand for Directors

Gross IPO Proceeds (in USD billions) (right)

IPOs (left)

Source: SPACInsider.com
*Through April 2



Finally, directors and officers (D&O) liability insurance premiums for SPAC directors have skyrocketed in recent months, and some insurers are unwilling to underwrite D&O coverage. As a result, some SPACs are cutting back on the amount or duration of coverage, which could leave directors exposed (including for litigation expenses) as litigation increases. This is particularly noteworthy because most SPACs require that directors waive any claim against the funds raised by the SPAC in its initial public offering and held in trust for the business combination. As SPACs typically have little cash apart from those trust funds, an indemnity from the SPAC may provide little comfort to directors.

Practical note: The risk profile of a prospective SPAC board seat depends on the quality and integrity of the sponsor and the other board members. Other things being equal, serving on a Cayman SPAC board offering appropriate D&O insurance is a much less risky proposition than serving on a Delaware SPAC board with inadequate D&O coverage.

What are the personal benefits of serving on a SPAC board?

SPAC directors gain visibility and potentially valuable new contacts with sponsors, fellow board members and deal professionals. In addition, SPAC board service may be a path to a board seat on the combined public company board.

Public company boards are generally required to have a majority of independent directors. By contrast, many of the private companies combining with SPACs have few, if any, independent directors, so there are natural opportunities for independent SPAC directors (who have no interest in the business combination transaction) to transition to the board of the combined company. SPAC directors are a ready-made pool of candidates familiar with the business, and a sponsor does not need to engage a search firm to find them.

In light of Nasdaq's recent policy favoring board diversity, women and diverse SPAC directors may find themselves in particularly high demand as candidates for boards formed after a SPAC has merged into an operating company.

Practical note: Usually there is no (or very nominal) cash compensation for SPAC directors, though a sponsor will typically transfer a portion of its "founder shares" to SPAC directors. However, underwriters increasingly want SPAC directors to have "skin in the game," so a director may be expected to make an out-of-pocket investment in the SPAC.

What conflicts of interest should I be aware of?

SPAC directors must disclose any potential personal conflicts they have to fellow board members, and to public shareholders when shareholders are asked to approve a business combination transaction. SPAC directors should consider whether the ownership of "founder shares" or private warrants in the SPAC creates the appearance of a conflict

of interest, since the sponsor, officers and directors may enjoy benefits that are not shared with the public shareholders if a de-SPAC transaction is completed.

Practical note: Usually there is no (or very nominal) cash compensation for SPAC directors, though a sponsor will typically transfer a portion of its "founder shares" to SPAC directors. However, underwriters increasingly want SPAC directors to have "skin in the game," so a director may be expected to make an out-of-pocket investment in the SPAC.

Directors need to be fully aware of the financial interests of the sponsor in any potential target. Many sponsors are affiliated with venture capital or private equity funds, which may have funds invested in potential targets of the SPAC. Sometimes, existing investors in the target company or persons affiliated with the SPAC seek to invest via a PIPE (private investment in public equity) when the SPAC combines with an operating company. Any potential conflicts should be carefully analyzed by the board and disclosed to shareholders. In some cases, directors representing the sponsor may recuse themselves or a special committee may be formed.

Where the sponsor is a "serial SPACer" (*i.e.*, a sponsor of multiple SPACs), the sponsor may be searching for targets for more than one SPAC at the same time and could steer opportunities to another of its SPACs. Although SPACs are legally permitted to waive the sponsor's and directors' obligations to bring all opportunities to the SPAC (and most SPAC charters do so), this does not override the duty of SPAC directors to act in the best interests of the corporation and its shareholders.

Practical note: Independent SPAC directors may know little about the sponsor's activities vis-a-vis its other SPACs and should ask appropriate questions to become adequately informed.

What could possibly go wrong?

In addition to attracting significant scrutiny and questioning by media and other observers, and posing the risk of private litigation, SPACs are on the radar at the Securities and Exchange Commission (SEC), which has shown concern about the number of SPACs, the attention garnered by "celebrity sponsors" and the resulting flow of retail investor dollars into these vehicles. The SEC has also focused on disclosure of the sponsor's economic incentives and how they may diverge from the interests of public shareholders, and on potential conflicts between shareholders and the sponsor, officers and directors. In addition, the commission's acting director of the Division of Corporation Finance recently addressed target company projections, which are typically included in de-SPAC registration statements. Although participants in ordinary mergers are generally protected

from private suits based on projections in registration statements, the acting director questioned whether this "safe harbor" should apply to de-SPAC transactions.

The SEC also wants investors to know how thoroughly a SPAC has vetted potential targets so shareholders can make an informed decision about any transaction a board recommends. The SEC recently sent letters to underwriters requesting information about their due diligence processes, suggesting a formal investigation in this area may be imminent. SPAC sponsors and even directors may also be subject to scrutiny regarding their due diligence efforts.

Upon completion of the de-SPAC transaction, the combined company will need the requisite expertise, reliable books and records, and sufficient internal controls to ensure investors receive reliable financial reporting. Because a target company's capabilities in these areas may be inadequate for a public company, it is important that a SPAC director who continues onto the public board gets comfortable with the expertise and skills of the combined company board and management team.

Practical note: The mere appearance of a conflict of interest, a lax due diligence process or a board that is not "public company ready" could result in litigation, unwanted attention from the media and/or SEC scrutiny.

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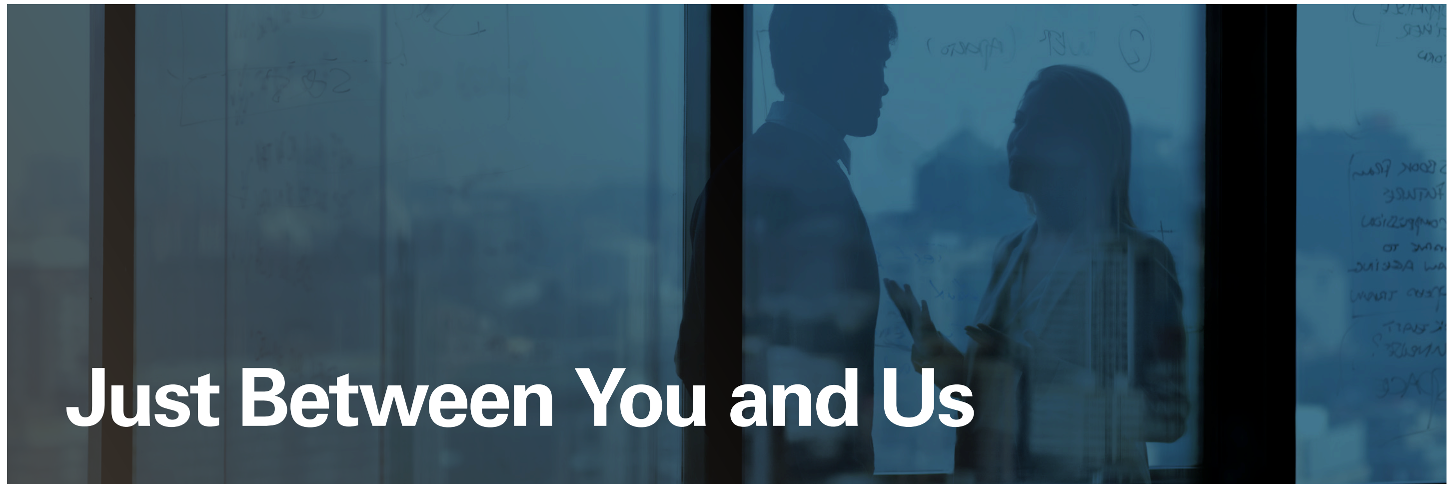

Just Between You and Us

The technical requirements of the attorney-client privilege can trip up clients who aren't careful. Here's a list of common misconceptions and real-world foot faults we've seen.

The 10 most common client misconceptions about the attorney-client privilege

Protecting corporate confidences has become more challenging in the COVID-19 world, as directors and executives work from home and other locales where it can be hard to control who is privy to discussions.

Among the most sensitive corporate confidences are communications with the company's lawyers, which are protected from disclosure to third parties by the attorney-client privilege. A client can inadvertently do things that prevent assertion of the privilege, so it is worth reviewing common misconceptions about how it works.

Four basic requirements must be met: (1) There must be a communication (2) between counsel and client (3) in confidence (4) for the purpose of seeking, obtaining or providing legal assistance to the client. Only if all four conditions are satisfied can clients refuse to turn over documents or testify about their communications with counsel.

The easiest way to grasp these rules is to review common misconceptions about the privilege:

1. *"If I copy our lawyer on an email to my fellow board members, that will make it attorney-client privileged."*

   No. Merely including a lawyer does not protect the communication. It has to meet all four requirements.

2. *"If I write 'attorney-client privileged' at the top of the email, address it to our lawyer and copy the rest of the board when I discuss the business merits of an M&A deal, that ought to work."*

   No. If the subject is the business merits of the deal, it would not satisfy the fourth requirement for attorney-client privilege. Conversations with lawyers that do not

relate to the seeking, obtaining or providing of legal advice are not protected.

3. *"I described a confidential, off-the-record call with a counterparty to our outside counsel. The back-channel conversation will be privileged and confidential, right?"*

   No. The call with the counterparty is not privileged, and recounting it to the attorney does not create a privileged communication with the lawyer unless the client asks for advice about the exchange with the counterparty or some other subject.

Simply cc'ing your lawyer on a note to others, even if you write "privileged" on the top of a document, will not ensure that the communication is protected.

4. *"If it's just our outside counsel, internal counsel, the board and our bankers in the boardroom when we discuss legal issues surrounding the deal, that should be privileged."*

   The answer will vary by state. The Delaware courts have recognized that financial advice is intertwined with issues of regulation, legal structure and legal consequences, and have held that the privilege is not waived simply because bankers are present. Other states might apply the privilege more narrowly. Beware, too, that if the topics extend to issues unrelated to the deal, the best practice is to excuse the bankers from those discussions to avoid any risk of waiving the privilege.

5. *"If we have our law firm hire our PR firm to draft alternative responses to a potential activist attack, the draft releases will be privileged because the lawyers hired the PR firm."*

   No. If the PR firm's input is not required to provide legal advice, the fact that outside counsel hired it would not matter, and sending draft releases to counsel would not make them privileged. There are some circumstances in which it may be easier to protect confidences if outside counsel hires third parties, but one should not assume that the privilege will apply simply because of who hired the third party.

6. *"Texts typically don't need to be turned over in litigation, unlike emails."*

   No. In discovery, "document" is defined broadly and may cover everything from letters and emails to doodles and text messages. Most texts are written quickly, without reflection on how they may look later with the benefit of hindsight, and they are often more revealing than more formal types of communication. Hence, they can provide ammunition to adversaries in litigation. It's best for directors to avoid texting about substantive matters generally.

7. *"If I ask our attorney for legal advice in an email and our attorney responds, the existence of those emails won't be disclosed to anyone."*

   No. In litigation, the parties often must prepare lists of any communications they contend are privileged, listing the date, subject matter and participants — including third parties — in order for the other side to evaluate and possibly challenge the claim of privilege. Hence, the existence of the emails and the recipients may be disclosed even if their substance is protected by the privilege.

8. *"If we have a presentation from our litigation counsel about potential damages the company may face in a suit and a summary becomes part of the board record, I assume that remains privileged even though our auditors review the board minutes, because the auditors were not given the lawyers' presentation."*

   No. Although the report itself may be protected by the privilege, a summary such as the minutes would probably have to be turned over in discovery if it went to a third party, like auditors who were not involved in the legal advice process. For that reason, companies should consider redacting privileged portions of records they share with people outside the circle of privilege.

9. *"A lawyer was retained to advise a special committee of the board investigating potential wrongdoing by a member of management. She sent me an email with preliminary findings, which I shared with directors who are not on the committee, because they should know what's going on. I assumed that will stay privileged."*

   Not necessarily. The special committee is the client here, not the full board. Sharing the lawyer's findings with directors not on the special committee could waive the privilege, because the other directors are outside the attorney-client relationship of the special committee.

10. *"If an outside board member receives privileged email at another business email address, it remains privileged."*

    Not necessarily. Communications exchanged on third-party email systems or electronic devices may not be privileged if the user did not have a reasonable expectation of privacy. Whether there is reasonable expectation may hinge on the policies of the email provider. (Some businesses maintain the right to monitor employees' communications on their systems.) To protect the privilege, directors need to examine the policies for the email they want to use. Companies may want to give outside directors company email accounts or require them to use dedicated, secure personal email accounts for all communications related to their board work.

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Shareholder Suits Demand More Progress on Diversity

Your board has women and underrepresented minorities. Yet you may still be targeted by a new wave of shareholder derivative suits pressing companies to take aggressive actions to further promote diversity and inclusion.

In a striking illustration of today's significant and increasing focus on diversity and inclusion in corporate America, at least 12 public companies recently have been sued by their own shareholders, who accuse directors and officers of failing to diversify their boards and C-suites and comply with anti-discrimination laws. The suits also typically allege that the companies falsely touted their commitment to diversity. The claims are cast as derivative suits, in which a shareholder seeks to bring claims on behalf of the corporation. The companies sued have spanned a wide range of industries, from Big Tech to health care and retail.

These suits warrant particular attention because:

- Companies with women and/or minorities on boards and senior executive teams have been sued.
- The remedies sought are ones rarely, if ever, pursued in shareholder derivative suits, such as the replacement of specific board members, the disgorgement of some directors' fees and the filling of a set percentage of new employee positions with members of certain demographic groups.
- Because derivative suits are brought by shareholders in the company's name, directors and executives frequently are named individually as defendants based on allegations that they violated their fiduciary duties to the company.

To date, there has been only one court ruling in these cases (see our March 31, 2021, client alert "California District Court Dismisses Derivative Suit Against Facebook Board Members and Executives Challenging Alleged Lack of Diversity"), so it is too early to gauge their full impact. But they highlight the need for boards to consider sound diversity and inclusion policies, document them appropriately and portray them accurately in public statements.

What the Plaintiffs Demand

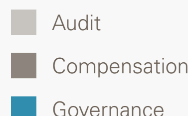
Some of the complaints appear to be framed to garner maximum press attention. One calls management of the target company "one of the oldest and most egregious 'Old Boys' Club' in Silicon Valley," and another alleges that the company's CEO "wants Blacks to be seen but not heard."

Some suits demand the removal of directors and would force some to repay their fees for serving. Others would mandate hiring fixed percentages of underrepresented minorities.

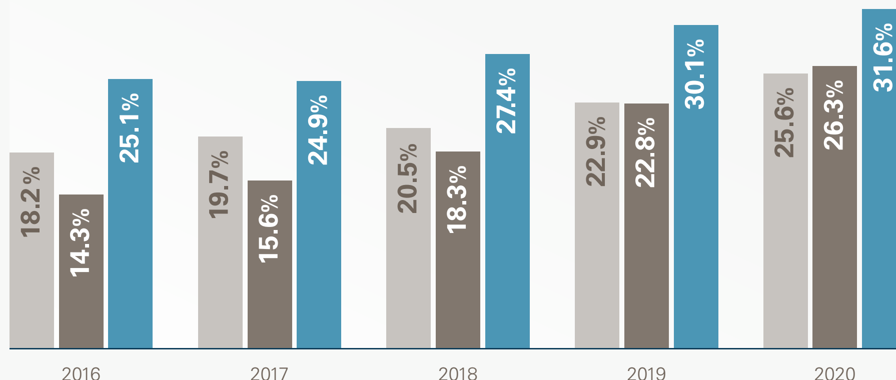
The suits aim to force specific changes at the companies themselves and, in some cases, to require them to contribute to or participate in diversity and inclusion efforts outside the corporation. Some of the more unusual forms of relief sought include:

- Replacement of the board chairman
- Resignation of at least three current directors and "a resolution to replace such directors with two Black persons and one other minority"
- Return of all director defendants' compensation, including any stock grants, to be donated to "an acceptable charity or organization whose efforts include the advancement of Black people and minorities in corporate America"
- "Creation of a $1 billion fund to hire Black and minority employees"
- Investment of "$100 million in economic and social justice programs for the African American community designed to address historical racial disparities"
- Financing of "100 education scholarships valued at $100,000 each for K-12 African-American students annually at partner schools located in the communities in which the company does business"
- Publication of annual reports containing detailed information about hiring, advancement, promotion and pay equity of all minorities at the company
- Filling of "15% of all new positions in the United States with African-Americans"
- Mandatory annual training for directors and executives on "diversity, affirmative action, anti-discrimination and anti-harassment"
- Replacement of the company's auditor for allegedly "failing to point out ... that the company lacks an effective system of internal controls to ensure [it] is not discriminating against minorities and is complying with its stated goals and initiatives."

Women Are Leading More Key Board Committees



Source: Equilar Board Factbook
Figures for Equilar 500
(largest U.S. companies by revenue)



Expect More Shareholder Demands

The plaintiffs generally have not exercised their rights as shareholders to inspect the company's books and records before filing suit. As a result, the complaints have contained few details about the boards' internal processes and deliberations, and are vulnerable if defendants move to dismiss them. Indeed, one suit was dismissed on several grounds, but the court gave the plaintiff the opportunity to refile it to correct the shortcomings, some of which might have been addressed if the plaintiffs had first requested and reviewed company records. Accordingly, we predict there will be more shareholder demands to inspect corporate books and records so future complaints can include more particularized allegations.

What To Do: Preventive Measures

In addition to employing effective diversity and inclusion policies, companies can minimize the risks of these sorts of derivative suits by taking certain actions, including:

- **Considering diverse candidates in board refreshment.** New or newly open board seats can create opportunities to diversify the board.
- **Documenting board or committee discussions on diversity and inclusion.** Engage in and memorialize board discussions on diversity and inclusion, and consider setting appropriate goals and measuring progress toward them. Documentation of these discussions can be provided in

response to shareholder requests and may persuade plaintiffs' lawyers that a claim would not be successful.

- **Monitoring public disclosures on commitments to diversity.** Boards and companies may wish to disclose the efforts and commitments they make, but they should avoid overly aspirational statements that could later be cast as false or misleading.
- **Recognizing that prior allegations of racial or gender discrimination can be cited in a derivative suit.** Prior governmental enforcement actions, civil suits and settlements have been cited in some derivative complaints as evidence that directors have breached their fiduciary duties to ensure compliance with anti-discrimination laws and have endorsed false or misleading statements about their companies' policies and conduct.

(See other practical suggestions in "The Search for Board Diversity: Practical Tips, Statistics on Progress.")

Conclusion

Supporting diversity and inclusion has become a priority in the business world, and companies and their boards are under great scrutiny with respect to their commitments to these goals. As we noted, even some companies with relatively diverse boards and senior management have been sued. Companies should consider taking steps to help reduce the risk of a suit and facilitate the defense of any that are filed.

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The Search for Board Diversity: Practical Tips, Statistics on Progress

Corporate governance thought leaders offer pragmatic suggestions for companies and directors aiming to diversify their boards, C-suites and employee ranks.

A panel of corporate governance thought leaders and public company directors at a recent webinar on diversity and inclusion within corporate boards offered practical guidance for boards on ways to meet their companies' goals, as well as some statistics about the progress made in recent years.

Suggestions To Improve Diversity and Inclusion

- Don't begin your search for new directors by polling the existing board for people they might recommend and assessing candidates supplied by recruiters who have not received direction on diversity criteria. This approach may limit the potential range of candidates at the outset.

- Don't restrict the search to current or former CEOs and chief financial officers. Companies can tap into a much larger, more diverse pool of candidates if they consider people who have held other executive positions that involve contact with boards.

- Use recently created databases that include tens of thousands of candidates, sourced in part from groups promoting diversity. Consider instructing recruiters to focus on diversity criteria or engaging recruiters who make diversity and inclusion a priority.

- Consider adopting a version of the "Rooney Rule," following the NFL's lead, and require that diverse candidates be included in at least the first round of any management hiring process.

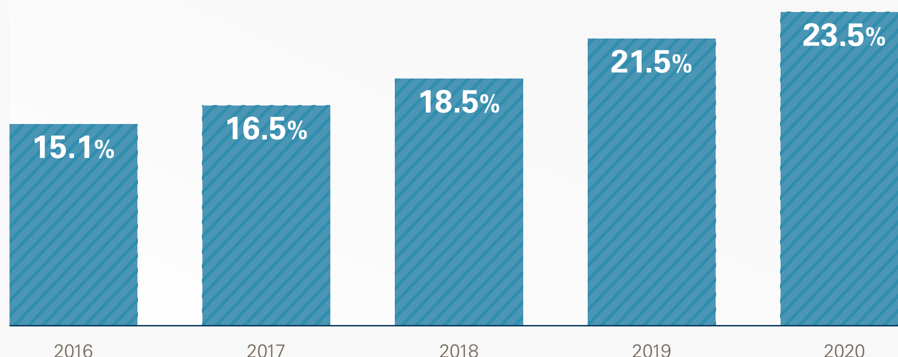
Statistics

- Women now comprise about 23% of directors at Russell 3000 companies, up from 15% three years ago, according to data from Equilar, and underrepre-

The Proportion of Women Directors Has Risen

Women Directors

Source: Equilar Board Factbook
Figures for Russell 3000, Q4 of each year



sented racial groups hold 12.5% of all seats. New board appointments are currently about 50-50 men and women.

- The gender balance at California companies has improved since the state enacted a law mandating diversity on boards of public companies headquartered there. California has risen from 35th place to 13th place nationally, based on the number of women on California corporate boards. Assuming all California companies are in full compliance with the law by the end of 2021 and there are no major changes in other states, California is projected to move up to second place.
- At least 11 other states have passed or are considering laws similar to California's, though most have less rigid targets, in part because of concerns that California's law may be vulnerable to a constitutional challenge.

Panelists:

Raquel Fox, SEC Reporting and Compliance partner at Skadden (moderator), and former director of the Office of International Affairs at the Securities and Exchange Commission (SEC) and senior adviser to then-SEC Chairman Jay Clayton.

David Chun, founder and CEO of Equilar, which provides corporate leadership data and is a source of potential board candidates.

Joseph Grundfest, professor, Stanford Law School, a former SEC commissioner and current director of KKR & Co. Inc. who specializes in capital markets, corporate governance and securities litigation.

Robin Washington, a director of Alphabet, Inc., Honeywell International, Inc. and Salesforce Inc., and former executive vice president and CFO of Gilead Sciences, Inc.

Click here for audio of the webinar.

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