From expert to director:
How to navigate the complexities and scrutiny of public company board service

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Becoming a first-time director of a public company is a goal not easily achieved and can represent a significant personal and professional accomplishment, giving an individual a platform to share their expertise to help a company attain its strategic objectives.

Although fiduciary duties under state corporate law are well established and not the primary focus of this article, public company directors are encumbered by a multitude of duties and responsibilities mandated by federal securities laws and the regulations of securities exchanges. A new director is expected to navigate ancillary restrictions, heighted scrutiny, and various challenges that can be onerous.

These factors necessitate careful consideration prior to accepting a first-time nomination or appointment to the board of a public company. It is important that you familiarize yourself with the legal implications resulting from your new role as a director, which we summarize in this article.

Disclosure obligations

Directors must be prepared to share meaningful personal information – and have it scrutinized by the general public, including potentially antagonistic parties. Public companies are required to disclose various information about their directors (including director nominees) in their proxy statements or annual reports on Form 10-K, which are filed with the US Securities and Exchange Commission (SEC). New directors should prepare to deal with the consequences of the following information being disclosed:

- **Biographical information.** Companies must describe the business experience of each director for the past five years, including occupation, employer, qualifications and skills, and other public company directorships. To meet this disclosure requirement, companies often solicit such information through a directors' and officers' questionnaire (D&O Questionnaire). In the case of a new director, a company may conduct a background check in addition to relying on the D&O Questionnaire. It is not unusual for this process to reveal discrepancies between a director's biography used in other formats and the background check, so best practice is to address any informational inconsistencies prior to public disclosure.
- **Compensation.** Companies must disclose annual compensation paid to directors, including retainers and equity awards, and the aggregate number of stock and option awards outstanding at fiscal year-end (even if awarded in prior years). Compensation deemed as "excessive" for a director may attract unwanted scrutiny from investors, regulators, and other corporate stakeholders.
- **Family relationships and related party transactions.** Any family relationship between a director and another director or executive officer of the company must be disclosed.

In addition, any transaction involving the company that exceeds $120,000, and in which a director has a direct or indirect material interest, must be reported in the company's SEC filings. This includes, for example, transactions with companies at which the director owns a ten-percent interest or salary paid to immediate family members of the director working at the company.

A director is expected to exercise great care in completing the D&O Questionnaire. Failure to accurately disclose information in the D&O Questionnaire may have a range of negative consequences, from an inaccurate determination of a director's independence status to enforcement actions and civil penalties against the director. The D&O questionnaire can be a lengthy and dense document, and a new director is encouraged to consult with counsel to ensure the accuracy of the information provided in response thereof.

In addition, under Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), directors must report ownership of and transactions in the company's stock (*eg*, grants, purchases, sales, or gifts) by timely filing Section 16 reports with the SEC – these reports are publicly available. Section 16 of the Exchange Act is designed for company insiders to return any profits made from the purchase and sale of company stock if both transactions occur within a six-month period (*ie*, a "short-swing" transaction).

Although most companies will file these reports on behalf of directors as an accommodation, a director is expected to promptly report any such transactions to the company to determine whether Section 16 reporting is triggered and, if so, ensure the timely filing of such reports, which in most cases is required within two business days of the transaction. Compliance with Section 16 and lack thereof can be scrutinized by regulators and the plaintiffs' bar and have undesirable consequences, which may be avoided by understanding the fundamental requirements of Section 16 and having a reliable compliance system in place. Public companies are required to report any "delinquent" Section 16 reports in their proxy statements, inviting further unwanted attention to a director.

Furthermore, Section 13(d) of the Exchange Act requires certain holders of more than five percent of a company's equity securities registered under the Exchange Act to file a beneficial ownership statement on Schedule 13D with the SEC. Generally, a director who becomes subject to Section 13(d) reporting will have to file a Schedule 13D within five business days of exceeding the five-percent ownership threshold and must file an amendment to Schedule 13D within two business days following a material change in the previously reported beneficial ownership. Similar to Section 16 filings, any Schedule 13D filing by a director is likely to attract attention from shareholders, regulators, and other stakeholders.

Other restrictions

Securities trading

Most public companies have insider trading policies that govern when directors, executive officers, and other insiders can engage in transaction in the company's securities and the procedures for doing so. Such policies help to ensure compliance with Exchange Act Rule 10b-5, which prohibits trading of securities while in possession of material nonpublic information (MNPI) (*ie,* insider trading).

Most notably, companies regularly impose blackout periods that prohibit trading by insiders, typically starting two weeks prior to the end of each fiscal quarter until after the company's quarterly results have been announced and digested by the markets, which is often in the middle of the second month of the next fiscal quarter.

Absent a 10b5-1 trading plan, blackout periods limit directors to only transact in company securities during a few weeks each quarter. Even then, the director may be in possession of MNPI, such as a material acquisition or disposition, financing, share buyback, or change in leadership, that might prohibit the director from transacting in the company's securities.

Most public companies have insider trading policies to prevent trading while in possession of MNPI and to comply with Exchange Act Rule 10b-5. To trade more flexibly and avoid insider trading risk, a director may adopt a written 10b5-1 plan that sets a formula and timing for trading in the company's securities over which the director has no discretion.

Such plans, referred to as "10b5-1 plans," must be entered into (i) when the director is unaware of any MNPI, (ii) in good faith, and (iii) not to evade Rule 10b-5's prohibitions. Such plans can provide an affirmative defense to insider trading charges. The director must inform the company of any 10b5-1 plan or changes to it, and the company must disclose them in its periodic filings. Most insider trading policies require insiders to have their proposed 10b5-1 plans approved by the company prior to entering into them. No transactions can take place under the plan until after a cooling-off period of at least 90 days.

An insider trading policy with preclearance procedures may also prevent the director from violating Section 16(b) of the Exchange Act, which allows a company to disgorge from a director (or other insider) any profits made from short-swing transactions in company securities. Such procedures may require the director to get pre-approval of any trades in the company's securities, even if they are not in possession of MNPI to facilitate the detection of trades that would violate Section 16(b).

Directors, as company affiliates, also face limitations on resales under the Securities Act of 1933, as amended (Securities Act). Unless a registration statement covers the resale of the securities held by directors, such securities may only be sold in compliance with the volume, manner of sale, and current public information requirements under Securities Act Rule 144 (and, if the securities were issued to the director in an unregistered transaction, a six-month holding period). Pre-clearance for such trades will also help to ensure compliance with Rule 144.

MNPI pitfalls

Directors of public companies very often are in possession of a company's MNPI, which raises the risk of inadvertent disclosure, insider trading, violations of Regulation Fair Disclosure (Regulation FD), and indications of compromised internal controls.

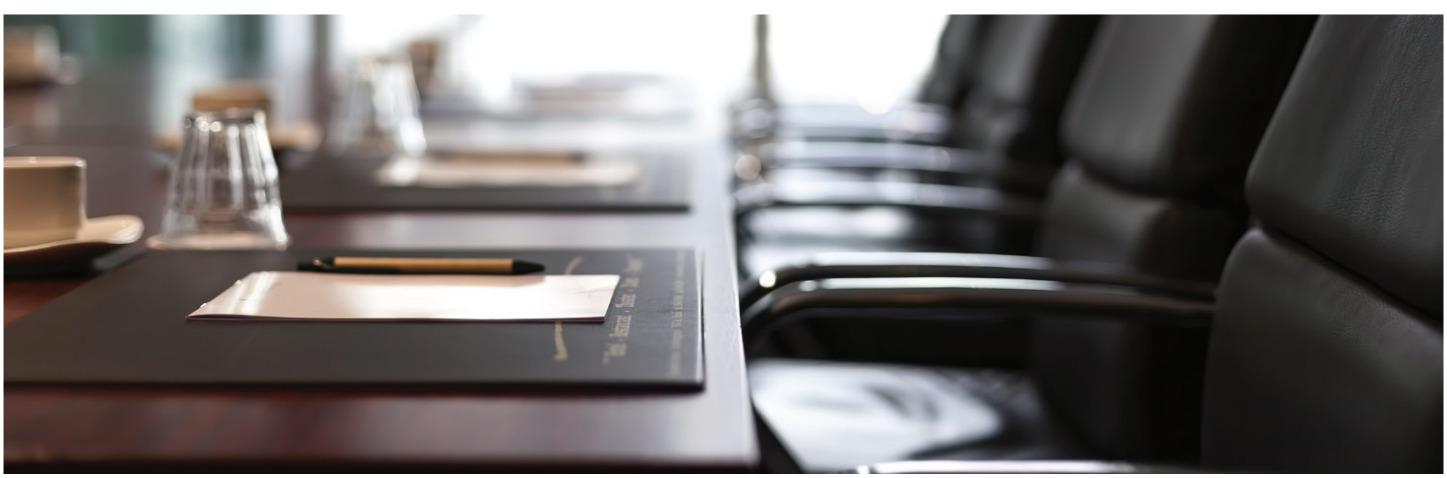
Regulation FD of the Exchange Act prohibits a public company from selectively disclosing MNPI to securities market professionals and shareholders unless it makes this information publicly available through Regulation FD compliant channels. Sometimes a director may be required to engage with investors and such conversations can raise Regulation FD concerns. New directors are encouraged to understand a company's reporting cadence to ensure compliance with quiet periods and trading window restrictions, and to consult with internal or external legal counsel regarding the scope of information to be shared ahead of any events or meetings, such as shareholder engagement meetings.

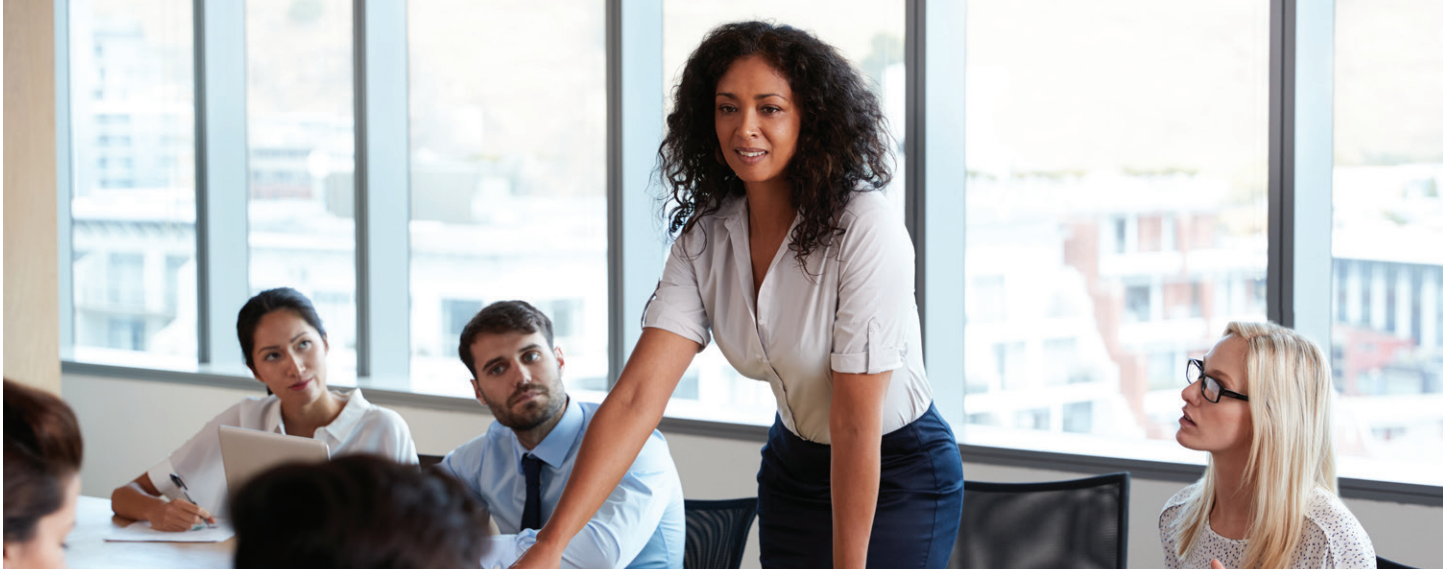
Stock ownership

Many public companies have stock ownership guidelines for directors. Such policies may require a director to hold a certain amount or percentage of the company's stock and may prohibit them from pledging or hedging the company's stock, curtailing the director's ability to engage in routine risk mitigation or financial planning activities using the company's stock. While such guidelines may help to ensure long-term alignment of interests between directors and shareholders, they can also impact tax planning, portfolio diversification, estate planning, and other personal objectives of the director.

Competitive interlocks

Section 8 of the Clayton Act prohibits an individual from serving as an officer or director of competing companies. A director may need to resign or be restricted from joining another company as a board member or officer if that company is deemed to compete with their current company. In the last few years, both the Federal Trade Commission and the US Department of Justice (DOJ) have prioritized compliance with the Clayton Act, and, in April 2024, the DOJ announced that it is scrutinizing overlapping executives and directors among artificial intelligence companies. A director or director nominee is encouraged to assess whether, based on their current or planned outside activities, appointment would raise Clayton Act concerns.





Additional scrutiny

In addition to the obligations and restrictions noted above, public company directors are regularly scrutinized by shareholders, shareholder advisory firms, and other stakeholders, such as when a company is missing earnings guidance, receives less than 70 percent support on say-on-pay vote, or is viewed as having weak corporate governance.

For example, in a proxy contest, an activist investor or dissident shareholder may vote against a director nominee or propose an alternative slate of nominees, and it is not uncommon for activist investors to publish negative information about an incumbent director's background, experience, or personal relationships. The SEC also recently adopted the universal proxy rules that require the inclusion of alternative nominees on the company's proxy card to make easier the selection of directors by shareholders.

Shareholder advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis, play a significant role in institutional investor voting. Board expertise, composition, and risk oversight are topics of particular focus for both ISS and Glass Lewis and often lead to comments on a director and their background. A director who is viewed as overcommitted, not sufficiently independent from management, or serving on a board committee that is deemed to be performing inconsistently with the advisory firms' expectations may garner a negative vote recommendation from shareholder advisory firms.

While generally more constrained than activist investor campaigns, proxy advisory firms may widely circulate such negative recommendations, specifically naming the director. A new director should be prepared to withstand the scrutiny and the potentially negative publicity that may arise in such situations.

Directors may face additional scrutiny and liability when approving transactions involving related persons or in which there are actual or perceived conflicts of interests. Such transactions, and the conduct and roles of directors in approving them often is carefully examined, including in litigation.

In evaluating these transactions, Delaware courts have generally applied a stricter standard of review unless, from the beginning, a functioning special committee of independent directors negotiates the transaction, and the transaction is approved by a majority of disinterested shareholders. In some cases, the relationship between the directors who sat on the special committee and the interested party has been closely scrutinized. An individual considering joining a board is encouraged to consider any potential conflicts that may exist or develop and how they should be disclosed and considered in the context of any corporate action.

Adjusting to the board

A new director will typically participate in an onboarding process that will allow them to understand the board's and the company's distinct culture. In addition to learning about fiduciary duties, board and committee roles, and the company's operations and strategic plans – which are recommended to be part of the onboarding process – a new director is encouraged to build relationships with the other directors to gain greater context and insights into board dynamics and corporate issues and to learn from the experiences, backgrounds, and perspectives of the other directors.

Successful onboarding programs for new directors often involve one-on-one meetings, dinners, and other activities primarily intended to help new directors connect with the other directors. However, if this is not part of the company's program, the new director should consider informally conducting such outreach.

Effective onboarding may also allow a new director to be better prepared to actively participate in board deliberations, including voicing dissent and challenging long-established practices and procedures when appropriate. Although board collegiality is important, a director should communicate and act in a manner they believe to be in the best interests of the company and in accordance with their fiduciary duties. To maintain a constructive board culture, directors should avoid letting disagreements over dissenting views escalate into hostility or damage their collaboration.

It may take time for a new director to learn the most effective way to find their voice within an established board. Strong board leadership can ease the acclimation of new directors by encouraging active participation and soliciting opinions. In turn, a new director is encouraged to understand the board's leadership structure, including its relationship with the company's chief executive officer (CEO) and other senior executives. In instances in which the board chairperson and CEO roles are combined, the new director may look to the lead independent director to ensure that the views of nonexecutive directors are communicated and that the board effectively exercises its oversight responsibilities.

Time commitment

Public company board service often requires a considerable amount of a director's time – and a person considering board service is encouraged to consider whether they have the capacity to adequately prepare for and perform the role. In moments of crisis or significant developments for the company, the board will generally be asked to meet frequently, and potentially at a moment's notice, to weigh in on critical issues whose outcomes may significantly alter the company and its future.

Meetings are often held in person and may require travel. Directors are encouraged to thoroughly review all materials made available prior to meetings. Such materials may include prior board and board committee minutes, resolutions to be voted on, management reports and proposals, and training materials. Reading these materials in advance may allow the board to have more substantive conversations during the meeting and prepare directors to ask more focused questions during meetings.

In addition, directors are often asked to serve on one or more board committees, which have separate meetings and delegated authorities and responsibilities. Committee activities increase the time commitment and responsibilities of each member, particularly in moments of crisis or during significant developments.

Finally, as noted earlier, shareholder advisory firms may recommend that investors vote against the election of a director who they deem to be "over-boarded" or otherwise too busy to perform the role effectively. For these reasons, directors and nominees are encouraged to give careful thought to the requisite time commitment.

Conclusion

Directors play a crucial role in shaping the strategic direction and providing risk oversight of a public company. While certainly a career highlight for many, being a public company director has legal significance beyond the validation of one's expertise and thought leadership in their industry. A new director is encouraged to understand and be prepared to take on the duties – and the challenges – of board service, helping ensure a successful tenure that will benefit the director, the company, and its shareholders. It all should start with having a better understanding of what public company board service entails and committing oneself to the role's demands.

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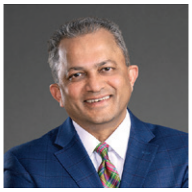

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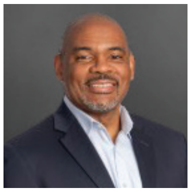

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