DIRECTOR CONFIDENTIALITY

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I
INTRODUCTION

The Hewlett-Packard board-leak-investigation scandal in 2006 and the push for board representation by shareholder activists both focused attention on the obligation of directors to maintain the confidentiality of corporate information.[1] There is, however, sparse analysis of that aspect of director duties in American legal materials. The Corporate Directors Guidebook contains the bare proposition that "a director must keep confidential all matters involving the corporation that have not been disclosed to the public."[2] The Guidebook also provides the following supporting material:

> A director who improperly disclosed nonpublic information to persons outside the corporation could harm the corporation's competitive position or damage investor relations and, if the information is material, could trigger personal liability as a tipper of inside information or cause the corporation to violate federal securities laws. Equally important, the unauthorized disclosure of nonpublic information by directors can damage the bond of trust between and among directors and management, discourage candid discussions, and jeopardize boardroom effectiveness and director collaboration.[3]

This article explores the need to modify the flat recitation of a rule of director confidentiality in light of the limited authority for a blanket restriction, and the necessary exceptions in the business contexts in which the issue arises. In particular, many situations do not involve damage to the corporation, or there is express or implied consent to the sharing of information.

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1. James Stewart, *The Kona Files*, NEW YORKER, Feb. 19 & 26, 2007, at 152 (discussing the Hewlett-Packard investigation); *see, e.g.*, Memorandum from Wachtell, Lipton, Rosen & Katz to Law Firm Clients on Boardroom Confidentiality (Sept. 26, 2006) (on file with author); Memorandum from Fried Frank to Law Firm Clients About Hewlett-Packard: A Caution for Company Directors (Sept. 28, 2006) (on file with author); *see* Charles Nathan, *Maintaining Board Confidentiality*, THE HARVARD LAW SCH. FORUM ON CORPORATE GOVERNANCE AND FIN. REGULATION (Jan. 23, 2010), http://blogs.law.harvard.edu/corpgov/2010/01/23maintaining-board-confidentiality (discussing directors nominated by shareholder activists); *see also* Viet Dinh, *Dunn and Dusted*, WALL ST. J., Sept. 26, 2006, at A14.

2. COMM. ON CORPORATE LAWS, ABA SECTION OF BUS. LAW, CORPORATE DIRECTOR'S GUIDEBOOK (5th ed. 2007), *reprinted in* 62 BUS. LAW. 1479, 1500 (2007).

3. *Id.* The last sentence quoted was added in 2007, apparently in the aftermath of the Hewlett-Packard scandal.

II
SOURCES

A. Statutes

A confidentiality requirement does not arise directly from statutory formulations. Section 8.30 of the Model Business Corporation Act (MBCA) describes the following director standard of conduct:

> (a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.
>
> (b) The members of the board of directors . . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.[4]

Most state statutes, notably excluding Delaware, contain similar formulations.[5] The Official Comment to section 8.30 states that section 8.30(b) is often characterized as a duty of care and that "[s]ection 8.30(a) establishes the basic standards of conduct for all directors," including a duty of loyalty.[6] Although there is no discussion in the Official Comment of a director's duty of confidentiality to the corporation, section 8.30(c) does deal with director disclosures to the corporation's board or a committee, and contains an exception to the obligation because of a "legally enforceable obligation of confidentiality."[7] Section 8.62(b) contains the same exception.[8] The Official Comment to section 8.62(b) uses the example of "common directors who find themselves in the position of dual fiduciary obligations that clash."[9]

B. Restatements

Although corporate directors are neither trustees nor agents, there are sufficient similarities in the positions to allow references to the more-established bodies of law in dealing with fiduciary duties of trustees and agents to use those principles in defining the obligations of corporate directors.

The Restatement (Third) of Trusts section 78 states as to the duty of loyalty:

> (1) [A] trustee has a duty to administer the trust solely in the interest of the beneficiaries . . . .
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> (2) . . . [T]he trustee is strictly prohibited from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee's fiduciary duties and personal interests.
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> . . . .

4. MODEL BUS. CORP. ACT § 8.30(a)–(b) (2008).
5. *See* MODEL BUS. CORP. ACT ANN. § 8.30, statutory comparison (4th ed. 2008).
6. MODEL BUS. CORP. ACT § 8.30 cmt. 1–2 (2008).
7. *Id.* § 8.30(c).
8. *Id.* § 8.62(b).
9. *Id.* § 8.62(b) cmt. 2.

> Additional General Comment:
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> i. Associated duty of confidentiality. Incident to the duty of loyalty, but necessarily more flexible in its application, is the trustee's duty to preserve the confidentiality and privacy of trust information from disclosure to third persons, except as required by law (e.g., rules of regulatory, supervisory, or taxing authorities) or as necessary or appropriate to proper administration of the trust. Thus, the trustee's duty of loyalty carries with it a related duty to avoid unwarranted disclosure of information acquired as trustee whenever the trustee should know that the effect of disclosure would be detrimental to possible transactions involving the trust estate or otherwise to the interests of the beneficiaries.[10]

The Restatement (Second) of Agency provides:

> Duties of Loyalty § 395. Using or Disclosing Confidential Information
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> Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal . . . in competition with or to the injury of the principal, on his own account or on behalf of another . . . .[11]

The Restatement (Third) of Agency states this obligation more simply:

> § 8.05 Use of Principal's Property; Use of Confidential Information
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> An agent has a duty . . . (2) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party.
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> . . . .
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> For the standard applicable to directors and senior executives of a corporation, see Principles of Corporate Governance: Analysis and Recommendations § 504.
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> . . . .
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> Comment:
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> c. Confidential information. Many employees and other agents are given access by the principal to information that the principal would not wish to be revealed or used, except as the principal directs. Such information may pertain to the principal's business plans, personnel, nonpublic financial results, and operational practices, among a range of possibilities. The value of some types of confidential information is recognized by trade-secret law, which protects "any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others."[12]

The reference to the American Law Institute (ALI) Principles of Corporate Governance (Principles) leads to a pertinent formulation:

> a. General Rule. A director . . . may not use corporate property, material non-public corporate information, or corporate position to secure a pecuniary benefit, unless either:
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> . . . .
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> . . . (3) The use is solely of corporate information, and is not in connection with trading of the corporation's securities, is not a use of proprietary information of the corporation, and does not harm the corporation;
>
> (4) The use . . . is authorized in advance or ratified by disinterested directors . . . .[13]

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10. RESTATEMENT (THIRD) OF TRUSTS § 78 (2007).
11. RESTATEMENT (SECOND) OF AGENCY § 395 (1958).
12. RESTATEMENT (THIRD) OF AGENCY § 8.05 (2006).
13. PRINCIPLES OF CORPORATE GOVERNANCE § 5.04 (2005).

The Principles' refinements as to the distinction between proprietary and nonproprietary information, harm to the corporation, and authorization point to the exceptions that are necessary to modify broad statements of director confidentiality.

C. Case Law

1. General

There is little case authority dealing directly with a director's duty to maintain the confidentiality of corporate information. As might be expected, most of the pertinent cases are in Delaware and vary according to context. In these cases, confidentiality is treated as part of a general duty of loyalty. For example, in *Hollinger International, Inc. v. Black*, the court held that the defendant violated his fiduciary duty of loyalty to the plaintiff because he "improperly us[ed] confidential information belonging to International to advance his own personal interests and not those of International, without authorization from his fellow directors."[14]

Similarly, in *Venoco, Inc. v. Eson*,[15] the court found that directors misused confidential information. Upon considering its prior decisions, the court stated, "It is well-settled that directors 'are not permitted to use their position of trust and confidence to further their private interests' because the law 'requires an undivided and unselfish loyalty to the corporation [and] demand that there shall be no conflict between duty and self-interest.'"[16]

Finally, in *In re Oracle Corp. Derivative Litigation*,[17] Vice Chancellor Strine quoted his earlier summarization of the rule dealing with insider trading, as follows:

> Delaware law has long held—see Brophy v. City Service, Inc.—that directors who misuse company information to profit at the expense of innocent buyers of their stock should disgorge their profits. This doctrine is not designed to punish inadvertence, but to police intentional misconduct. As then-Vice Chancellor Berger noted, Brophy is rooted in trust principles that provide "that, if a person in a confidential or fiduciary position, in breach of his duty, uses his knowledge to make a profit for himself, he is accountable for such profit."[18]

These Delaware cases and scattered cases in other jurisdictions indicate that material corporate information, like other corporate property, cannot be used for personal gain.

A more complicated exposition of the duty to maintain corporate confidentiality arises when there is a conflicted duty to disclose the information. In *Malone v. Brincat*, the Delaware Supreme Court assumed a duty of confidentiality, stating, "The directors' duty to disclose all available material

14. Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1061–62 (Del. Ch. 2004).
15. Venoco, Inc. v. Eson, No. 19506-NC, 2002 Del. Ch. LEXIS 65, at *20 (Del. Ch. June 6, 2002).
16. *Id.* (quoting Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. Ch. 1939)).
17. *In re* Oracle Corp. Derivative Litig., 867 A.2d 904 (Del. Ch. 2004).
18. *Id.* at 933.

information in connection with a request for shareholder action must be balanced against its concomitant duty to protect the corporate enterprise, in particular, by keeping certain financial information confidential."[19]

2. Director and Shareholder Inspection

The most complete case analysis of corporate confidentiality is found in determining what limitations can be imposed on director and shareholder inspection rights. Faced with an inspection demand, corporations often seek to withhold some information as confidential or demand confidentiality agreements as a condition of inspection.[20] In *Disney v. Walt Disney Co.*,[21] the court noted that the Court of Chancery will often condition its judgment in section 220 cases on the entry of a reasonable confidentiality order, and stated that withholding of information in a confidentiality order could be overcome in connection with litigation.[22] The *Disney* inspection situation is unusual because the information in dispute had previously been available to the plaintiff when he was a director of the corporation and the court relied heavily on the corporation director confidentiality policy that the plaintiff had approved.[23]

In *Holdgreiwe v. The Nostalgia Network, Inc.*, the plaintiff was a nominee of a major shareholder that was in a dispute with another shareholder in a struggle for control of the corporation.[24] Plaintiff director made a demand for inspection.[25] After rejecting the corporation's claim that the demand was for an improper purpose, the Court of Chancery dealt with the request that the plaintiff be required to sign a confidentiality agreement.[26] The court denied the request, stating, "He is already under an obligation to maintain the confidences of Nostalgia; to use its confidential information only to inform discussions among directors and action by the board or a committee. Disclosure of such information to AVI is a violation of duty whether or not an undertaking is entered."[27]

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19. Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998) (citing Stroud v. Grace, 606 A.2d 75, 89 (Del. 1992)).

20. *See* Stephen A. Radin, *Developments in the Law: The New Stage of Corporate Governance Litigation: Section 220 Demands—Reprise*, 28 CARDOZO L. REV. 1287, 1388 (2006).

21. Disney v. Walt Disney Co., 857 A.2d 444 (Del. Ch. 2004); *see generally* Lawrence A. Hamermesh, *Twenty Years After* Smith v. Van Gorkon*: An Essay on the Limits of Civil Liability of Corporate Directors and the Role of Shareholder Inspection Rights*, 45 WASHBURN L.J. 283 (2006) (discussing case).

22. *Disney*, 857 A.2d at 448.

23. Disney v. Walt Disney Co., No. 234-N, 2005 Del. Ch. LEXIS 94, at *12–13 (Del Ch. June 20, 2005).

24. Holdgreiwe v. The Nostalgia Network, Inc., No. 12914, 1993 WL 144604, at *329 (Del. Ch. Apr. 29, 1993).

25. *Id.* at *328.

26. *Id.* at *336.

27. *Id.*

In contrast, at least as to sharing information with a sponsor, the court in *Kortum v. Webasto Sunroofs, Inc.*[28] held that a director representative of a fifty percent shareholder in a joint-venture corporation was entitled to inspect all the books and records without limitations. With respect to requests to prevent the sharing of the information with the fifty percent shareholder (WAG), the court stated:

> Nor is it reasonable to condition Kortum's inspection upon an undertaking not to disclose to WAG any information gleaned from the document inspection. Kortum is a fiduciary of WSI, but he is a fiduciary of WAG as well. Absent a conflict between those two roles, Kortum's fiduciary duty would require him to disclose that information to WAG, which is one of WSI's 50% owners. . . . Magna has not established a conflict between Kortum's two fiduciary roles.[29]

The court went on to indicate that "it must be presumed that Kortum, as a fiduciary of WSI, will not disclose WSI's proprietary or confidential information to such third parties. Therefore, Kortum is encouraged, but will not be required, to bind himself to that non-disclosure restriction."[30] In *Kortum*, the court relied on *Henshaw v. American Cement Corp.*,[31] where the court stated that the director had shown a purpose germane to his position as a director and:

> His purpose is not improper because of the possibility that he may abuse his position as a director and make information available to persons hostile to the Corporation or otherwise not entitled to it. If Henshaw does violate his fiduciary duty in this regard, then the Corporation has its remedy in the courts.[32]

D. Commentators

There is no comprehensive general discussion of director confidentiality in American legal texts.[33] For example, a leading Delaware text contains the simple statement that "the duty of loyalty also requires that directors maintain the confidentiality of corporate information."[34]

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28. Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113 (Del. Ch. 2000).

29. *Id.* at 121.

30. *Id.* at 121 n.17.

31. Henshaw v. Am. Cement Corp., 252 A.2d 125 (Del. Ch. 1969).

32. *Id.* at 129.

33. *But see* R.P. Austin, *Representatives and Fiduciary Responsibilities—Notes on Nominee Directorships and Life Arrangements*, 7 BOND L. REV. 19, 19 (1995):

> There is a perennial debate in the literature of company law about the duties of a "nominee" director. Discussion is particularly intense in Australia, New Zealand and Canada, possibly because in the relatively small business communities of those countries interlocking corporate relationships are more common than in, say, the United States and the United Kingdom.
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> . . . .
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> There are, however, some applications of the general fiduciary principles which may well have real and immediate practical consequences. They relate to corporate information. Is the company entitled to withhold information from a nominee director whose nominator is thought to be acting contrary to the company's interests? When, if at all, can a nominee director pass on corporate information, acquired in the boardroom, to his or her nominator?

34. R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.16, at 4-118. (3d ed. 2009 & Supp. 2010), *reprinted in* Nathan, *supra* note 1.

Law firm publications and blog postings supply some useful direct commentary. One 2010 firm newsletter distinguishes between company information and board information, such as the content of director discussions, and urges the use of policy statements that cover both categories.[35] It also discusses the usually overlooked absence of legal remedies available to discipline directors who improperly disclose company information, even if there is a policy statement in place that would cover the situation.[36] The presence of a policy statement, however, was important in the *Disney* shareholder inspection case.[37] Since directors cannot remove other directors,[38] in the absence of extreme circumstances that would support an injunction against disclosures, damages, or removal by shareholders or a court, the only formal remedy against an offending director is a refusal to renominate.

A useful summary of confidentiality issues is contained in a 2008 article concerning "designated directors" as follows:

> What happens when the designating investor expects the designated director to report to the investor on non-public financial results, board discussions, potential corporate actions, and board decisions? On the one hand, the investor specifically sought board representation so that it could keep a watchful eye over its investment and receive exactly this type of report. On the other hand, the designated director has independent fiduciary duties to the corporation and all of its shareholders, which duties are usually understood to include a duty to maintain the confidences of the corporation. There is little law or commentary addressing this situation, but it appears that reporting to the investor should be permissible, as long as it does not harm the corporation or the other shareholders, is not prohibited by a specific corporate policy, and does not result in trading on inside information.
>
> Some of the uncertainty arises from the fact that there is no explicit source for a director's duty of confidentiality. It is usually inferred from either the duty of care, the duty of loyalty, or both. Some corporations adopt a policy of confidentiality or a policy limiting those people who are allowed to speak to outsiders. If such policy is in writing and in sufficient detail, there is an explicit understanding among the directors and the investors as to the limits on disclosure. In many companies, particularly private companies, however, a confidentiality policy and its exact parameters, limits, and exceptions are not explicit or in writing. As a result, disputes may occur concerning how much or to whom a director may reveal information.[39]

35. *Corp. Governance Comment on Board Confidentiality*, CORP. GOVERNANCE COMMENT. (Latham & Watkins), Dec. 2009*, reprinted in* Nathan, *supra* note 1.

36. *Id.*

37. Disney v. Walt Disney Co., No. 234-N, 2005 Del. Ch. LEXIS 94, at *12–13 (Del. Ch. June 20, 2005).

38. BALOTTI & FINKELSTEIN, *supra* note 34, at 4-14.

39. David Morris, Lois Herzeca & Julie E. Kamps, *Designated Directors and Designating Investors: Early Planning is Key*, 16 CORP. GOVERNANCE ADVISOR 5, 5 (May/June 2008) (internal citations omitted).

III
ANALYSIS

As indicated in the ALI Principles formulation,[40] the necessary qualifications to a general rule of confidentiality are in the areas of materiality and consent.

A. Materiality

Not all nonpublic information about a corporation needs to be treated as confidential.[41] Section 5.04 of the Principles[42] suggests that only proprietary information, meaning trade secrets and similarly important information, needs protection. For example, a director usually can discuss corporate history or general business issues, even if the information is not easily available to the public. Therefore, a form of materiality qualifier is needed. Section 5.04 uses the phrase "material non-public information."[43]

Similarly, both the Restatement (Second) of Agency and Principles refer to misuse of information that causes injury to the corporation.[44] It follows that there is no breach of duty by a director who discloses information unless the information is significant enough that its disclosure could cause some form of injury. The injury could either be the disclosure of proprietary information or a boardroom leak that causes embarrassment or director mistrust.

B. Consent

After confidential information is defined to include only material information, the next question is whether the corporation has consented to its disclosure by the director. In many business situations, the corporation provides material corporate information to outsiders with the protection of a confidentiality agreement to prevent misuse. Financing and other business transactions require the furnishing of material information. Investment agreements with venture capitalists and other investors provide for information rights.[45] Sometimes directors are authorized to speak for the corporation.[46] As the Restatements of Agency provide, disclosing information with the consent of the corporation is not a breach of duty.[47] Therefore, statements such as "fiduciary duties generally will trump contractual expectations in the corporate

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40. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 13.

41. *See* Amalgamated Bank v. UICI, No. 884-N, 2005 WL 1377432, at *5–6 (Del. Ch. June 2, 2005) ("Ultimately, the question of whether a document is entitled to confidential treatment requires a balancing of various considerations within a specific context.").

42. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 13.

43. *Id.*

44. *See supra* notes 11, 13 and accompanying text.

45. *See*, *e.g.*, Michael J. Halloran et al., *Investor Rights Agreement, in* 1 VENTURE CAPITAL & PUBLIC OFFERING NEGOTIATION, 9–40 (2007 Supp.).

46. Ironically, it appears that the director at the center of the Hewlett-Packard board-leak controversy thought that he was authorized to speak to reporters. *See* Dinh, *supra* note 1.

47. *See supra* notes 11, 12 and accompanying text.

context"[48] need some refinement to reflect consent. When there is consent by contract, fiduciary duty is modified and action taken pursuant to the consent is consistent with the director's fiduciary duties. The qualifier "unless the corporation consents" should be imposed on statements of a duty of confidentiality.

When there is no express consent, the ability of a director to share confidences depends on whether the consent can be implied by the circumstances. Close corporations provide the most important example of implied consent. It is generally understood that close corporations may be subject to different treatment of confidential information sharing than corporations with publicly traded securities. In the *Kortum* case discussed above,[49] the chancery court recognized that a designee of a fifty percent shareholder in a joint-venture corporation was expected to provide information to the corporation he represented. More generally as to representative directors and the close corporation, a classic analysis of director conflicts of interest states:

> In making this analysis I will confine the discussion to the case of a publicly-held corporation. The problem of conflict of interest in a closely-held corporation may well be significantly different in many cases. For example, a particular director or directors may have been placed on the board, with the express understanding and consent of all concerned, for the purpose of representing the interest of one particular shareholder or group of shareholders. If that is true, then there is no reason why he should not do exactly that, even though theoretically he may not be acting disinterestedly for the welfare of all the shareholders as a group.[50]

C. Exceptions

Beyond express and implied consent, there are other established exceptions to director confidentiality obligations. Indeed, the cases imposing confidentiality restrictions on information obtained pursuant to director inspection rights recognize that the information can be disclosed in litigation and in election contests.[51] Under securities rules, when a director resigns because of a disagreement, the corporation must state the reasons for the

48. *See* E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 774 (2008) (discussing the tension between contractual and fiduciary principles).

49. *See* Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113, 121 (Del. Ch. 2000).

50. Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 58 (1966) (internal citations omitted); *see* Veasey & Di Guglielmo, *supra* note 48, at 771–72 (recognizing close-corporation difference with respect to constituent directors); Joseph Hinsey, *The Constituency Director*, THE HARVARD LAW SCH. FORUM ON CORPORATE GOVERNANCE AND FIN. REGULATION (Jan. 14, 2008), http://blogs.law.harvard.edu/corpgov/2008/01/14/the-constituency-director; *see also* Stroud v. Grace, 606 A.2d 75, 89–90 (1992) (discussing disclosure to stockholders in close corporations).

51. *See* Disney v. Walt Disney Co., 857 A.2d 444, 448 (Del. Ch. 2004).

resignation; this might entail disclosure of otherwise confidential corporate or board information.[52]

D. Dual Directorships

As indicated above, the MBCA recognizes that there are situations when a director may be prevented from making disclosures to other directors or shareholders of a corporation because he also is a director of another corporation.[53] In this area, the cases and commentators sometimes refer to an undiminished fiduciary obligation to both corporations.[54] The modifications of materiality, consent, and recusal in cases of conflict alleviate most concerns in this area.

E. Representative Directors

Most difficulty concerning director duties in disclosure of information arises because a director is placed on the board to represent a corporate constituent. Several other issues concerning representative directors are more easily resolved: It is generally understood that representative directors should disclose their affiliation, will advocate the positions of their sponsor, and should recuse themselves in conflict situations.[55] Representative directors necessarily have loyalty to their sponsors who might be preferred shareholders,[56] controlling shareholders, joint venturers, family members, financial institutions, shareholder activists,[57] government agencies, private-equity funds,[58] venture capitalists,[59] labor unions,[60] directors elected through cumulative voting,[61] or

52. SEC Form 8-K, Item 5.02(a); *see* Stewart, *supra* note 1 (discussing a disagreement over disclosures concerning a resigning director in the Hewlett-Packard investigation scandal).

53. *See supra* note 7 and accompanying text.

54. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710–11 (Del. 1983); *see also* BALOTTI & FINKELSTEIN, *supra* note 34, at 4-148; I STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 811–16 (2009).

55. *See generally* Cyril Moscow, *The Representative Director Problem*, INSIGHTS 12 (June 2002); Veasey & Di Guglielmo, *supra* note 48; Hinsey, *supra* note 50. The terms representative director, constituent director, designated director, and nominee director are all used when a director is named to represent a shareholder or group of shareholders.

56. *See* Veasey & Di Guglielmo, *supra* note 48.

57. *See* Nathan, *supra* note 1.

58. *See* Carole Schiffman, *Current Issues for Private Equity Buyers*, Ninth Annual Private Equity Forum, 1683 PLI/Corp 107, 119–20 (2008) (describing the suggested handling of confidential information by directors of portfolio companies).

59. Venture capitalists and other investors often obtain observer rights to avoid director obligations. *See* Ellen Corenswet & Sarah Reed, *Venture Capital 2010: Nuts & Bolts, Introduction to Venture Capital Deal Terms*, 1799 PLI/Corp. 35, 47 (2010):

> One or more investors may have the right to appoint an observer who, although not a Board member, will be entitled to attend all Board meetings and receive all materials, notices, etc. sent to the Board. Note that these individuals do not have fiduciary obligations to the company and, absent contractual terms, do not have confidentiality obligations with respect to the information they receive.

60. *See* Moscow, *supra* note 55, at 13–14.

61. *See* Hinsey, *supra* note 50.

other directors designated by persons other than corporate management. The issue is mitigated because many representative director confidentiality situations will fall within the express and implied consent exceptions described above. As an example of implied consent, it can be assumed that a representative of the U.S. Department of Treasury on a corporate board in connection with a federal investment will share financial information with his superiors, even if the investment agreement does not cover information transmittal. In addition, there are often express contract rights covering the providing of information and confidentiality agreements to prevent misuse of the information.[62] Although it has been said that, at least in the public-corporation area, the representative director ordinarily cannot be the "eyes and ears" of the sponsor,[63] materiality and consent modifications will permit information transmittal to the sponsor in most situations. With respect to directors designated by a controlling shareholder, such as a parent corporation, the cases impose fiduciary duties on the controlling person, apparently in part under the reasonable assumption that a representative director will supply information to the parent corporation.[64]

The greatest challenge is determining the confidentiality obligations of a representative director placed on the board without agreement through preferred-stock provisions, cumulative voting, or success in a proxy contest. In these situations, there is no contractual arrangement before the director is elected. Here again, the definitions and modifications described above come into play: To be restricted, (1) the information must fit the confidential category and (2) there must not be implied consent to information sharing because of the nature of the representation. It might even be argued that a director elected in a public corporation's hostile proxy contest has obtained the implied consent of shareholders to the sharing of information with the sponsor. Importantly, if the materiality limitations in agency law are followed, there must be misuse of the information and some relation to injury to the corporation or its shareholders before a breach of duty is found. Moreover, when the representative director obtains appropriate safeguards, such as a confidentiality agreement executed by the sponsor, the corporation ordinarily would not be injured or have other grounds for an objection in the absence of a business conflict with the sponsor.

As in most legal matters, when possible, advance planning and contract are the preferred remedies to potential conflicts. When these remedies are not available to deal with disclosure of information, the materiality of the information, based on the context in which it is being transmitted, should govern whether a director breached a duty to the corporation in transmitting the information to the sponsor. Statements of corporate policy that deal with confidentiality provide useful guidelines. They may, however, conflict with the

62. For a sample confidentiality agreement with a representative of a shareholder activist, see PERSHING SQUARE CAPITAL MANAGEMENT, L.P., 2008 SCHEDULE 13D FILING (2008).

63. Veasey & Di Guglielmo, *supra* note 48.

64. *See* RADIN, *supra* note 54, at 1154–71.

function of a representative director imposed upon a hostile management, as indicated in the following comment from counsel for shareholder activists:

> A common company policy, for example, requires directors to keep company information confidential, which may present an issue for a nominee proposed by, and especially one who is affiliated with, activist investors. An activist that achieves the election of its nominee to the board often does so on the basis that the nominee's views will be more aligned with shareholder interests. The activist would like to be able to discuss company matters with that board member, at least to convey the activist's views on the company's conduct. The director will, of course, be required to act in accordance with his or her fiduciary duties and not on the instructions of the activist, and the activist, if privy to material non-public information about the company, would be restricted in trading (and typically would not want such information for that very reason). Discussions between the director and the activist would not make the information public, but might still violate company policy and, the company may argue, could even breach fiduciary duty.[65]

IV

CONCLUSION

The corporate statutes and cases do not establish a separate duty of confidentiality. The obligation of a corporate director to protect material corporate information is part of the overall duty to act reasonably in what the director believes are the corporation's best interests, which includes the general categories of care and loyalty. Material information encompasses both proprietary information, such as trade secrets, and board information, such as the content of board discussions. As in most business situations, express contractual consent is the best solution to the problem of disclosure of information. Confidentiality agreements can establish boundaries for the transmission of information and prevent misuse.

When there is no contractual consent, accepted business practices and expectations should prevail to establish implied consent. In close corporations, it is reasonable to assume implied consent to the communication to affiliates in most situations if there is no threatened misuse of the information. In both public and close corporations, it should be expected that directors representing a corporate constituency will share information with the sponsor when there is no conflict between the corporation and the sponsor. There are few formal remedies for breaches of the general confidentiality obligation or a corporate policy other than refusal to renominate a director.

The most difficult contemporary issue is the election of a nominee of a shareholder activist to the board of directors as a result of a successful proxy contest. In that situation, there is no prior agreement with the nominee or sponsor, and the transmission of information might conflict with a company policy. A possible solution in this situation is to assume that information will be

65. *See* Marc Weingarten & Erin Magnor, *Second Generation Advance Notification Bylaws*, THE HARVARD LAW SCH. FORUM ON CORPORATE GOVERNANCE AND FIN. REGULATION (Mar. 17, 2009), http://blogs.law.harvard.edu/corpgov/2009/03/17/second-generation-advance-notification-bylaws.

transmitted to the sponsor and impose confidentiality obligations on the sponsor. A confidentiality agreement between the representative and sponsor would mitigate the risk of abuse. When there is a conflict between a sponsor and the corporation, the general rules applicable to director conflicts should apply to the representative director. In any event, the simple statement that a director must keep corporate information confidential requires modification for materiality, consent, and the realities of a particular business situation.