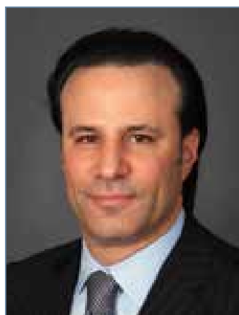
A Conversation with Boris Feldman, Iconic Silicon Valley Securities Litigator

Interview by Adam J. Epstein



Adam J. Epstein advises small-cap boards through his firm, Third Creek Advisors. He previously co-managed a hedge fund that invested in more than 500 small-cap financings. He is the author of *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies* (McGraw-Hill, 2012).

Boris Feldman is a partner at Wilson Sonsini Goodrich & Rosati in Palo Alto, California, where he specializes in securities litigation and counseling. Feldman has represented numerous companies—including Google, Netflix, Genentech, Facebook, Salesforce, Twitter, and Hewlett-Packard—and their officers in more than 200 lawsuits, including a dozen financial-restatement cases. Prior to Wilson Sonsini, Feldman, among other posts, served as special assistant to the legal advisor at the U.S. Department of State and as a law clerk to Judge Abraham D. Sofaer in the U.S. District Court for the Southern District of New York.

What securities litigation trends should directors be paying attention to in 2015?

Trend number one: suits in connection with mergers and acquisitions. If your company is buying others or selling itself, odds of a shareholder suit are nearly certain. These suits tend to have little or no impact on the deal, but you need to expect them and plan for them. Courts are becoming especially sensitive to conflicts on the investment-banker side.

Trend number two: shareholder derivative suits claiming breach of fiduciary duty. If you encounter any type of regulatory problem, some lawyer is likely to sue the entire board for failing to head it off in advance. The key event in a derivative suit is the motion to dismiss for failure to make demands on the board. This often turns on how the outside directors have handled stock sales. Outside directors who are going to trade should look at doing so through Rule 10b5-1 plans.

The use or abuse of Rule 10b5-1 trading plans has been the subject of recent articles and resulted in increased scrutiny on the timing of trades. What practices have emerged as a result?

These plans remain an effective way for directors and executives to diversify out of their company holdings over time. They make sense if the divestiture plan is simple. If the insider builds in lots of bells and whistles, the security provided by the plan goes down—plaintiffs' lawyers will argue that the plans were designed to play the market while appearing neutral. Critics have started analyzing the timing of company disclosures in relation to impending 10b5-1 sales. In some cases, plaintiffs have alleged that executives postponed disclosing bad news until after the previously scheduled sales had occurred. Thus, in making decisions whether to disclose information or not, management needs to talk to counsel about the impact that innocuous, prescheduled trades might have on public perceptions about the timing of the disclosures.

When you think back over hundreds of cases, are there certain corporate governance acts, omissions, or fact patterns that seem to repetitively give rise to liability in securities litigation?

The most common type of suit remains the "missed quarter" lawsuit: a company fails to meet Wall Street expectations for revenue or earnings. Over time, such suits have become less threatening to companies. If a company uses the right "safe harbor" warnings and has decent forecasting processes in place, it can win these lawsuits, often without any discovery. In general, the safe harbor disclosures are better and more effective at large-cap companies than at small-caps. If I were a director at a smaller public company, I'd ask outside counsel to talk with the board about how good or not that company's disclosures are compared to its peers. You would be surprised at how many public companies get the safe harbor language wrong.

The other recurrent pattern involves accounting problems, ranging from the technical to the incarcerable. Any restatement of financials, particularly with respect to revenue recognition, guarantees a shareholder suit. In general, large-caps often have more robust internal controls

than do younger public companies (although most of the notorious accounting meltdowns occurred at large, fancy companies). For audit committee members at our smaller public clients, I encourage them to talk face-to-face, on a regular basis, with the corporate controller and the head of credit and collections. This can flush out any problems, and the knowledge that this interview is coming may deter some employees from bad judgments. In addition, the internal audit function tends to be less fulsome at small-caps, a topic worthy of board attention.

When it comes to conducting internal investigations, what should directors keep in mind?

I would emphasize two imperatives that can sometimes conflict. First, you must be purer than Caesar's wife. The fruits of the investigation are likely to be presented to regulators and may be the subject of litigation. Staff is sensitive to whitewashes. Assume that every step you take—or don't take—will need to be justified to a skeptical critic. At the same time, don't go overboard, at least not right away. Not every internal complaint needs to be escalated to DEFCON 1 immediately. You should have an internal triage protocol to specify how different situations will be handled. For example, does the potential misconduct involve lower-level employees or senior executives? An unfortunate trend seems to be treating every potential problem as a huge problem. This can benefit lawyers and forensic accountants, but the company itself? Not so much.

Since small-cap boards often have directors with little public company governance experience, what are some issues they should focus on when determining the adequacy of a directors and officers liability policy prior to joining a board?

Memo to directors: this is your insurance. If there is a meltdown at the company and the indemnification rights evaporate in bankruptcy, you will need this insurance. Don't abdicate decisions on this to the risk manager or CFO. Make sure that there is analytical discussion at the board level. The key is not just aggregate amount. Of great importance are how the layers are structured and the identity of the carriers. Moreover, the particular terms of the policy can determine whether the protection is really available to you when you need it or is consumed by the arguable wrongdoers.

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Activist investors, particularly in the small-cap ecosystem, often focus on suboptimal board composition practices—and in many cases, rightfully so. What advice do you have for nominating/governance committee chairs about board composition?

The top priority, always, should be getting the right disciplines represented on the board. You should avoid populating the board with folks who are on other boards together and get along. You should also avoid picking directors because of their star status—they can often be less engaged than non-famous directors. The optimal time to think about activist shareholders and institutional investors is before you have a problem with them. Retool your investor relations function away from handling calls from individual investors and toward maintaining a meaningful channel of communications with the institutional community.

Email and text messages are the gifts that keep on giving for regulators and the plaintiffs' bar. If you were a director, how would you approach electronic communication?

I would not worry about it. Once created, a digital communication never disappears entirely—as we've seen recently with the "missing" IRS emails. Don't worry about double-deleting stuff—it won't help. Think before you hit "send." If you see communications that you think are phrased intemperately, have management reach out to that employee to work with them on document creation.

If there were one aspect you could change about the Delaware General Corporation Law or how it's been interpreted, what would it be, and why?

Some in Delaware manifest hostility toward venture capital investors (VCs) on public company boards. But if you talk to people active in the tech world, they will tell you that some of the truly great directors are VCs who have distributed their shares but still feel a commitment to the company and its team. This is not an issue of "clubiness," but of expertise. Delaware needs to ease up on its suspicion of these directors.