

message from partner in charge

With summer upon us, we often find ourselves looking for diversions. We hope you'll take some time out of your day and divert your attention to our latest *Wilmington Update*, which features stories about shareholder activism and how disclosure to certain directors may waive attorney-client privilege. This issue also includes an article that addresses the proposed regulation of credit card and overdraft practices.

Be sure to log on and listen to our recent recordings, including a Pepper and Eggs Webinar on Privacy & Security Compliance and a Pepper Podcast on the Perils of the Employee Free Choice Act.

As always, if you have any questions about any legal issue you or your company are experiencing, or would like further information about the topics discussed in this newsletter, give us a call.

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Best Practices for Working With Shareholder Activists

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Corporate boards of directors and management can — and should — be more proactive in preparing for and addressing increasing activism by shareholders.

Shareholder activism, which grew in 2007, is expected to continue to increase in 2008. Several factors led to this rise, including greater pressure to increase returns to shareholders and hedge funds seeking a variety of individual gains.

In addition, new Securities and Exchange Commission rules were established that permit less costly electronic proxy solicitations. This allows shareholders to avoid the burden of complying with numerous laws and communications rules, and they are not required to file and distribute significant amounts of paperwork. Also, the establishment of electronic forums allows shareholders to communicate and generate support for a cause without being in violation of proxy rules.

Shareholders now hold boards of directors and management more accountable for company performance and corporate governance, and dissident shareholders have achieved some notable successes.

Vocal and active shareholders often promote one particular issue that may not be in the best interests of the remaining shareholder base. Their objectives also can force board members to focus on short-term, rather than long-term, goals. At times, shareholder activists can distract boards of directors from focusing on their primary duties to provide strategic direction and oversee management.

While management and the boards of directors of public companies have always tried to balance Wall Street's demand for quarter-to-quarter performance with actions aimed at long-term growth, the now pervasive scope of activist shareholders makes that balance more difficult to achieve.

For example, hedge funds pressure management with the ultimate goal of obtaining board seats, special dividends and stock buybacks. Often, they also seek the board's commitment to explore the sale of the business or force a company to negotiate better terms for shareholders.

Shareholder activism is forcing boards of directors to respond more directly to the concerns and demands of large shareholders. These demands include greater accountability for executive compensation, board representation and short-term strategic options to enhance shareholder value. Shareholders' concerns are particularly prominent with respect to companies with languishing returns.

Companies can adopt several proactive approaches to address increased shareholder activism, thus enabling them to be ahead of, rather than behind, the trend, including:

- educating directors regarding the tactics of activist shareholders, as well as the obligations of management and boards of directors to individual shareholders
- continually reviewing, analyzing and improving corporate governance
- thoroughly analyzing executive compensation, linking pay to performance
- evaluating periodically the composition and performance of the board of directors
- holding meetings with prominent shareholders and listening to their concerns
- communicating to shareholders the key priorities of management, realistic benchmarks and milestones that shareholders can use to evaluate progress

- monitoring shareholders, including chat rooms, to understand who they are
- fully analyzing takeover defenses.

These are appropriate corporate governance measures regardless of the activist shareholder initiative. Furthermore, the measures can serve to address the concerns of all shareholders before potentially disruptive activities of shareholder activists.

The goal of any company should always be to alleviate shareholder concerns before they reach a crisis point. However, should a lawsuit, proxy contest or activist shareholder challenge arise, boards of directors and management need to be informed, deliberate and consistent in their response. They also need not be fatalistic, despite the significant power activist shareholders have gained in recent years. Each situation requires individual attention, the ability to develop and implement appropriate, measured responses, along with a realistic assessment of when to fight and when to forge a suitable settlement.

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Mr. London and Mr. Gilman have formed Pepper's shareholder activism team.



Peppercast: The Perils of the Employee Free Choice Act

As the 2008 election cycle intensifies, the organized labor movement is devoting substantial resources to support candidates who will advance its ambitious legislative agenda in 2009, including passage of the Employee Free Choice Act (EFCA).

Jonathan Kane, a partner in the Philadelphia and Berwyn offices of Pepper Hamilton and chairman of the firm's Labor and Employment Group, discusses what passage of the EFCA would mean to employers and what they can do now to ensure that union organizers do not target their employees.

Listen today by visiting the Labor and Employment section of Pepper's podcenter at www.pepperpodcasts.com.

Disclosure to Certain Directors May Waive Attorney-Client Privilege

Disclosing attorney-client communications in connection with internal investigations and reports to corporations, board of directors and special committees may waive attorney-client privilege. A recent ruling out of the Delaware Court of Chancery provides important guidance to corporate counsel.

Chancellor William B. Chandler's decision in *Ryan v. Gifford*, 2007 WL 4259557 (Del. Ch. November 30, 2007), underscores the importance for counsel to identify clearly the client, those parties with interests adverse to the client, and those with common interests, before disclosing attorney-client communications.

In this case, the Delaware Court of Chancery held that a special committee formed to investigate stock option backdating at Maxim Integrated Products, Inc. waived the attorney-client privilege when the committee presented its final oral report to Maxim's board of directors.

Chancellor Chandler reasoned that the privilege was waived because a number of Maxim's directors in attendance were potentially liable for the stock option backdating violations, so they had interests potentially adverse to Maxim and the remainder of the board.

The decision was in response to a motion to compel production by plaintiff shareholders of Maxim in the underlying derivative and securities fraud litigation, in which plaintiffs sought disclosure of communications of the special committee's counsel to both the Maxim board and the special committee. The Court of Chancery ordered production of attorney-client communications between the special committee's counsel and the special committee.

While the special committee's presentation to the board of directors may have resulted in only a limited waiver of the privilege as to the presentation of the final report, the Chancellor found that the presentation's partial waiver operated as a complete waiver for all communications regarding the final report's subject matter of stock option backdating. The Chancellor concluded that the waiver of attorney-client privilege extended to all communications between the special committee and its counsel regarding the investigation and final report concerning stock option backdating.

A significant factor supporting the court's ruling that the special committee had waived the attorney-client privilege

was the amount of detail communicated by the special committee in its final oral report and the special committee's communication of these details to third persons not for the purpose of seeking legal advice. The court explained that the final oral report was presented in such detail that attendees were directed to turn in any notes taken during the presentation at the end of the meeting. The special committee presented the detailed final oral report to third-party individual directors who were named as defendants in the underlying litigation (and potentially adverse) as well as their counsel.

The court concluded that the relationship between the special committee and the individual named director defendants was adversarial in nature, precluding application of the common interest exception, which protects communications among parties who share a common interest from disclosure.

Most recently, Chancellor Chandler's decision in *Ryan v. Gifford*, 2008 WL 43699 (Del. Ch. January 2, 2008) denying Maxim's motion for certification of an interlocutory appeal of the November 30, 2007 decision, amplified the Chancellor's prior waiver of attorney-client privilege analysis concluding that "disclosure to outsiders has never failed to waive privilege under Delaware law."

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Pepper and Eggs Series Webinar Recording

Attendees at the most recent webinar on June 4 learned about a unified approach to security compliance that leads to simultaneous compliance with multiple laws and regulations. Listen to the webinar by visiting http://www.pepperlaw.com/pepper/webinars_update.cfm?rid=12.0.

Regulators Propose to Regulate Credit Card and Overdraft Practices

The Federal Reserve Board (the Fed), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA), have proposed long-anticipated regulations on unfair or deceptive acts or practices (UDAP) in the areas of credit card lending and overdraft protection. The proposal addresses such issues as: timing of payments, payment allocation, interest rates on outstanding balances, fees from credit holds, balance computation methods (double cycle billing), fees/deposits charged to an account for the issuance of credit, firm offers of credit, and issues related to overdraft protection policies.

The agencies' proposal is largely a reaction to criticism on Capitol Hill in response to the current credit crisis, for example, a warning from Chairman Barney Frank (D-MA) that with respect to their UDAP rulemaking authority, the agencies should "use it or lose it." But will this rulemaking bring uniformity to UDAP regulation? For now, the outlook is uncertain. In fact, it raises several issues as to the implementation of the rule. For many years, the OCC and FDIC have maintained that they already have the authority to apply and enforce the provisions of Section 5 of the Federal Trade Commission Act (the general federal statute on UDAP) through the regulators' panoply of enforcement tools under Section 8 of the Federal Deposit Insurance Act. The OCC and FDIC may adopt, through agency guidance, the Fed/OTS proposal, and then examine their institutions for compliance. The OCC and FDIC also might ignore the rule and instead continue to regulate their institutions through ad hoc enforcement actions.

How this rulemaking will impact state non-member banks will depend on the posture that the FDIC assumes on the proposed rule. If the FDIC decides to engage in rulemaking, the FDIC should make clear whether its standard is preemptive, whether state regulations on topics addressed by the federal rule are still applicable, or whether the federal standard merely forms the minimum standard and that states are free to apply more strict standards to institutions they supervise. These banks may argue that the federal UDAP standard preempts state UDAP laws as applied to banking activities, or that FDIC UDAP enforcement now supplants conflicting state enforcement. For states like Delaware and South Dakota, this proposal has the effect of declaring their statutes as permitting unfair and deceptive practices. Whether the Fed and OTS can preempt state laws in this manner is unclear.

This is definitely a rulemaking that financial institutions should follow and consider providing comment, either

individually or through trade associations. The industry's reaction to this round of UDAP rulemaking will be heard by the regulators – including those that were not parties to this rulemaking – in at least two important respects: as a counterpoint to opponents that may be clamoring for tougher UDAP regulations, and for the regulators in considering what their next area of UDAP regulations will be (e.g., real estate lending).

You may read this article in its entirety at http://www.pepperlaw.com/pepper/publications_update.cfm?rid=1425.0.

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