

**KNOCKING AT THE BOARDROOM DOOR: A
TRANSATLANTIC OVERVIEW OF DIRECTOR-
INSTITUTIONAL INVESTOR ENGAGEMENT IN LAW
AND PRACTICE**

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ABSTRACT

Under the current context of (re)concentrated ownership, institutional shareholders are expected to play a more active role in corporate settings by making managers more accountable and urging them to favor a long-term view of business prospects. Calls from institutional investors for engagement with boards of directors have grown and private dialogue with individual directors is now an important instrument of institutional investor activism. In spite of this favorable trend, director-shareholder dialogue is still problematic. Public disclosure and insider trading rules set legal constraints on board-shareholder engagement. However, the reach of these constraints should not be overstated, as they do not appear to ban outright all private dialogue between directors and shareholders. In this regard, recommendations within corporate governance and stewardship codes, and from practitioners, have played a major role in developing a practical framework for director-shareholder dialogue that seeks to prevent the violation of insider trading and public disclosure rules, and to make dialogue more effective. Against this backdrop, this article will provide a comparative transatlantic overview of recent developments in the area of director-institutional shareholder dialogue in the United States and in Europe with the aim of assessing the effective reach of legal constraints on board-shareholder dialogue under current legislation, and considering some practical solutions offered by corporate governance and

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stewardship codes that could facilitate board-shareholder engagement and enhance its effectiveness.

I. INTRODUCTION.....	189
II. FROM TRADITIONAL TO NEW INVESTOR RELATIONS: ENGAGEMENT BY INSTITUTIONAL SHAREHOLDERS AND PRIVATE MEETINGS WITH DIRECTORS.....	193
III. THE FAVORABLE TREND TOWARDS BOARD-SHAREHOLDER DIALOGUE WITHIN A CONTEXT OF ENHANCED INVESTORS’ ENGAGEMENT.....	196
A. The United States	197
B. The European Union	200
IV. LEGAL CONSTRAINTS ON BOARD-SHAREHOLDER ENGAGEMENT: THE MATERIALITY THRESHOLD.....	205
A. The compatibility of director-shareholder dialogue that does not concern material information with Regulation FD	206
B. The impediment on director-shareholder dialogue concerning inside information posed by the principle-of-equal-information-based EU Market Abuse Regulation.....	211
C. Board-shareholder dialogue concerning non-material information does not violate the EU law principle of equal treatment of shareholders.....	220
V. DEVELOPING A PRACTICAL FRAMEWORK FOR BOARD-SHAREHOLDER DIALOGUES.....	225
A. Identifying topics for dialogue.....	226
B. Selecting Participants in dialogue (on behalf of the company).....	231
C. Adopting and disclosing a policy on director-shareholder dialogue	237
VI. CONCLUSION	239

I. INTRODUCTION

INSTITUTIONAL investors play an ever-increasing role in the corporate governance of publicly traded companies worldwide. Since the 1990s in the United States, and more recently in Europe, institutional ownership of listed companies has grown significantly, leading to an increase in ownership concentration.¹ This development has rendered obsolete the traditional Berle & Means governance model, characterized by dispersed ownership of retail investors with no incentive to exercise their voting rights or monitor directors' activities and performance.²

In the current era of (re)concentrated ownership, institutional shareholders, who have the necessary knowledge and resources, are expected to play a more active role in corporate governance and to exert influence on the company's strategies,³ as:

[f]or investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture

¹ See Edward B. Rock, *Institutional Investors in Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 3–4 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2015); Ronald J. Gilson & Jeffrey N. Gordon, *Agency Capitalism: Further Implications of Equity Intermediation* 8–12 (Eur. Corp. Governance Inst. (ECGI), Law Working Paper No. 239/2014, Feb. 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2359690. See also Paula Loop et al., *The Changing Face of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 1, 2018), <https://corpgov.law.harvard.edu/2018/02/01/the-changing-face-of-shareholder-activism/> (noting that, in the United States, institutional investors hold around 70% of total outstanding equities). For the growing role played by institutional investors in Europe and, namely, in Germany, see Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493, 524–26 (2015).

² See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 864–68 (2013); Rock, *supra* note 1, at 11.

³ Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299, 300 (2008) (“The theory was simple: if shareholder monitoring could limit managers’ divergence from the goal of shareholder wealth maximization, then institutional shareholders were well positioned to act as effective monitors. Institutions held larger blocks of stock than most other investors and collectively held well over fifty percent of the stock of most large public companies. Acting together, these shareholders would have the power and the incentives to push for good corporate governance and to nudge managers to pursue wealth-maximizing strategies.”).

and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.⁴

Along these lines, institutional shareholders are expected to hold managers more accountable for company valuation and urge them to favor a long-term approach when making business decisions.⁵ As has clearly been asserted under European law, “[e]ffective and sustainable shareholder engagement is one of the cornerstones of the corporate governance model of listed companies, which depends on checks and balances between the different organs and different stakeholders.”⁶

Within the context of enhanced shareholder activism, calls from institutional investors for engagement with the board have grown. Private dialogue (“behind the scenes”) with directors is an important instrument of institutional investor activism.⁷ While, due to their informal nature, the precise

⁴ See FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE 1, 4 (2012), [hereinafter UK STEWARDSHIP CODE], <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx>. See generally David William Roberts, Note, *Agreement in Principle: A Compromise for Activist Shareholders from the UK Stewardship Code*, 48 VAND. J. TRANSNAT'L L. 543, 549–56 (2015) (illustrating the historical background of the Code).

⁵ See *European Commission Green Paper: The EU Corporate Governance Framework*, at 11, COM (2011) 164 final (Apr. 4, 2011), http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf (“Shareholder engagement is generally understood as actively monitoring companies, engaging in a dialogue with the company’s board, and using shareholder rights, including voting and cooperation with other shareholders, if need be to improve the governance of the investee company in the interests of long-term value creation.”). See also *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: European Company Law and Corporate Governance – a Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, at 8, COM (2012) 740 final (Dec. 12, 2012) [hereinafter Action Plan on European Company Law] (“If for instance the majority of shareholders remain passive, do not seek interaction with the company and do not vote, the functioning of the current corporate governance system is less effective. In such circumstances, no corrective action can be expected from the shareholders’ side and supervision of management rests entirely on the shoulders of the (supervisory) board.”). See generally Klaus J. Hopt, *Corporate Governance in Europe: A Critical Review of the European Commission’s Initiatives on Corporate Law and Corporate Governance*, 12 N.Y.U. J.L. & BUS. 139 (2015).

⁶ See Directive 2017/828, of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement, 2017 O.J. (L 132/1) 3 [hereinafter SHRD II].

⁷ See, e.g., Klaus J. Hopt, *The Dialogue Between the Chairman of the Board and Investors: The Practice in the UK, the Netherlands and Germany and the Future of the German Corporate Governance Code Under the New Chairman* (European Corp. Governance Inst., Law Working Paper No.

extent of private meetings between institutional investors and directors is not easy to measure,⁸ empirical analysis shows that private discussions with directors have become one of the most popular measures of shareholder engagement by institutional investors.⁹ Other public mechanisms (such as shareholder proposals or public criticism) are used only if interventions behind the scenes fail.¹⁰ This is because, as further studies suggest, private meetings with a company's directors and its management (and, more generally, activism behind the scenes) can create value and have an effective impact on issuers' decisions.¹¹

After a long period during which it was largely neglected, board-shareholder engagement is now under the spotlight. Legislators, financial market authorities, corporate governance institutions, and practitioners recommend dialogue between institutional investors and boards and seek to

365/2017, 2017), <https://ssrn.com/abstract=3030693>; Doron Levit, *Soft Shareholder Activism 2* (May 31, 2017) (unpublished manuscript) (on file with author), <https://ssrn.com/abstract=1969475>. See also Wolf-Georg Ringe, *Shareholder Activism: A Renaissance*, in *THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE* 3, 17 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2015).

⁸ Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 *REV. FIN. STUD.* 939, 942 (2010); Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuk-Strine Debate*, 12 *N.Y.U. J.L. & BUS.* 385, 396 (2016) (“Engagement often occurs privately—away from the scrutiny of the public and the media—and it is less measurable than a shareholder vote. Consequently, empirical research on the effectiveness of engagement is lacking.”).

⁹ Elroy Dimson et al., *Active Ownership*, 28 *REV. FIN. STUD.* 3225, 3226 (2015); Joseph A. McCahery et al., *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, 71 *J. FIN.* 2905, 2911–12 (2016); David Solomon & Eugene Soltes, *What Are We Meeting for? The Consequences of Private Meetings with Investors*, 58 *J.L. & ECON.* 325, 326–28 (2015). See also MARC GOLDSTEIN, *INV’R RESPONSIBILITY RESEARCH INST., DEFINING ENGAGEMENT: AN UPDATE ON THE EVOLVING RELATIONSHIP BETWEEN SHAREHOLDERS, DIRECTORS AND EXECUTIVES* 4 (Apr. 10, 2014), <https://irrcinstitute.org/wp-content/uploads/2015/09/engagement-between-corporations-and-investors-at-all-time-high1.pdf>. See generally Stefano Cascino et al., *Who Uses Financial Reports and for What Purpose? Evidence from Capital Providers*, 11 *ACCT. EUR.* 185 (2014).

¹⁰ See McCahery et al., *supra* note 9, at 2912.

¹¹ See Marco Becht et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 *REV. FIN. STUD.* 3093, 3097, 3108–18 (2009) (showing that “when the fund’s engagement objectives are achieved, there are economically large and statistically significant positive abnormal returns around the announcement date of the change”); Willard T. Carleton et al., *The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence from TIAA-CREF*, 53 *J. FIN.* 1335, 1336 (1998) (showing empirical evidence concerning private contacts of the Teachers Insurance Annuity Association–College Retirement Equities Fund’s contacts with investee companies) (“Of the 45 firms contacted by TIAA-CREF during the period from 1992 to 1996, 32 (71 percent) reached an agreement prior to TIAA-CREF’s proxy resolution being voted.”).

facilitate it.¹² In spite of this favorable trend, director-shareholder dialogue is still problematic. Public disclosure and insider trading rules set legal constraints on board-shareholder engagement.¹³ However, as illustrated in the following analysis, the reach of these constraints should not be overstated, as they do not appear to ban outright any private dialogue between directors and shareholders. In this regard, recommendations within corporate governance and stewardship codes, and from practitioners, play a major role in developing a practical framework for director-shareholder dialogue – a framework that seeks to prevent the violation of insider trading and public disclosure rules, and to make dialogue more effective.¹⁴

The purpose of this article is to provide a comparative transatlantic overview of recent developments in the area of director-institutional shareholder dialogue in the United States and in Europe. In so doing, the article aims to assess the effective reach of legal constraints on board-shareholder dialogue set by current legislation. Moreover, it considers practical solutions that could facilitate board-shareholder engagement and make it more effective.

To carry out this project, the article is structured as follows. Part II defines the scope of the analysis by clarifying the distinction between board-shareholder dialogue and traditional investor relations practices. Part III describes developments in board-shareholder dialogue in the United States and in Europe. In both contexts, the usefulness of such dialogue is generally acknowledged. Furthermore, both legislation and corporate governance and stewardship codes aim to favor communications between directors and key shareholders. Part IV considers the existing regulatory framework and concludes that legal constraints derived, on both sides of the Atlantic, from the selective disclosure and insider trading regimes (and in Europe also from the principle of equal treatment of shareholders) suggest that there is not any absolute ban on board-shareholder dialogue. Part V provides an overview of engagement practices in the United States and in the European Union, considering recommendations contained in corporate governance and

¹² See *infra* Part III.

¹³ Public disclosure and insider trading rules may hinder board-shareholder engagement insofar as they ban directors from selectively disclosing material information to some shareholders. For the U.S. context, see Regulation FD, 17 C.F.R. § 243.100(a) (2017); for the European Union context, see Regulation 596/2014 of the European Parliament and of the Council of 16 April 2014 on Market Abuse (Market Abuse Regulation) and Repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC, 2014 O.J. (L 173/1) [hereinafter MAR], at 25-26, 34-36.

¹⁴ See *infra* Part IV.

stewardship codes as well as best practice guidance. Finally, Part VI offers some concluding remarks.

II. FROM TRADITIONAL TO NEW INVESTOR RELATIONS: ENGAGEMENT BY INSTITUTIONAL SHAREHOLDERS AND PRIVATE MEETINGS WITH DIRECTORS

The issue of dialogue between listed companies and their shareholders is not new; the practice is already widespread.¹⁵ Since the 1990s, issuers' communications with shareholders have largely fallen within the responsibilities of firms' investor relations departments, which perform the function of informing investors, shareholders, and financial analysts of various corporate developments.¹⁶ As the National Investor Relations Institute has pointed out, traditional investor relations have the ultimate objective of contributing "to a company's securities achieving fair valuation."¹⁷

Within the framework of traditional investor relations, communications with shareholders can come in different forms depending first on the parties involved on the side of an issuer. That is, depending on who represents the firm's "voice": the chief investor relations officer, managers, or, less frequently, directors. Secondly, an issuer may communicate with its shareholders by means of periodic reports and press releases, by disseminating information through its

¹⁵ For an overview, see ADVISORY BD. ON CORP./INV'R ENGAGEMENT, THE CONFERENCE BD. GOVERNANCE CTR., GUIDELINES FOR INVESTOR ENGAGEMENT (2014), http://www.shareholderforum.com/access/Library/20140306_ConferenceBoard-Guidelines.pdf. See also James Kim & Jason D. Schloetzer, *Global Trends in Board-Shareholder Engagement, Director Notes 4* (The Conference Bd. Dir. Notes, Georgetown McDonough Sch. of Bus., Research Paper No. DN-V5N20, 2013), <https://ssrn.com/abstract=2335489> ("Although executives and directors remain cautious toward visible, public engagement activities, there is clearly a rising trend in shareholder engagement. This trend is by no means a 'Shareholder Spring,' but engagement is here to stay and will become more formal and more global.").

¹⁶ See, e.g., Edward B. Rock, *Shareholder Eugenics in the Public Corporation*, 97 CORNELL L. REV. 849, 868–71 (2012). For discussion of the European context, see Jens Ekkenga, *Kapitalmarktrechtliche Aspekte der Investor Relations*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 1 (2001); Holger Fleischer, *Investor Relations und informationelle Gleichbehandlung im Aktien-, Konzern- und Kapitalmarktrecht*, 38 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR) 505 (2009).

¹⁷ *About NIRI*, NAT'L INV'R RELATIONS INST., <https://www.niri.org/about-niri> (last visited Jan. 8, 2018) (The National Investor Relations Institute Board of Directors adopted the following definition of "investor relations": "[i]nvestor relations is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation.").

website or social media, or by organizing conference calls and face-to-face meetings. Such meetings, which are generally attended by an issuer's investor relations officers or senior managers (such as the Chief Financial Officer and General Counsel), may take place during shareholders' general meetings, or at other times, such as during financial roadshows,¹⁸ investor days (directed at the financial community), or one-on-one meetings with selected shareholders.

The forms of director-institutional shareholder dialogue considered in this article are different from traditional investor relations practices. As Professor Rock has observed, directors' strategic engagement with key shareholders represents a new form of investor relations and these interactions, compared to traditional investor relations, are "more episodic, led by high-level outside actors, and involve . . . the highest levels of the company."¹⁹ These "new" investor relations exercises have a different rationale, since they are not just simple marketing tools for the company's shares. Rather, institutional investors usually "knock on the boardroom door" in order to communicate their views or concerns about specific aspects of the company's governance and strategies, or in relation to specific transactions.²⁰ While traditional investor relations activities are aimed at promoting the issuers' securities, the engagement by directors with key shareholders considered here usually aims to listen to shareholders in order to gain insights into their views, opinions, and concerns. Thereby, the engagement helps to shape the issuer's relationship with institutional investors.²¹ Ultimately, director-institutional investor dialogue is a means of limiting litigation or avoiding more aggressive forms of shareholder activism such as shareholder proposals, proxy contests, or withdrawal.²² Thus,

¹⁸ Financial roadshows consist of a series of meetings, usually across different countries, in which directors and top executives have the opportunity to talk with current or potential investors.

¹⁹ Rock, *supra* note 16, at 895.

²⁰ ADVISORY BD. ON CORP./INV'R ENGAGEMENT, THE CONFERENCE BD. GOVERNANCE CTR., *supra* note 15, at 7 ("Such direct communication is not the routine engagement model for company and investor engagement in the United States, but it is an aspect of engagement that institutional investors expect during special circumstances or relating to specific governance or other matters where they may deem interaction with management to be insufficient or inappropriate.")

²¹ *See* Rock, *supra* note 16, at 896–97 (stressing that "[w]hat is so interesting about the role is that it takes shareholder empowerment as a given and asks how firms can improve relationships with their shareholders so that the shareholders will be supportive rather than resistant").

²² Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171, 197–205 (2009). *See also* Mallow & Sethi, *supra* note 8, at 392 (noting that "[e]ngaging with boards and firm executives on a continuous, long-term basis can bring about change through incremental, non-confrontational means").

as Professor Rock has pointed out, investor relations and corporate governance converge in the area of director-shareholder dialogues.²³

To better define the reach of this Article, it is also worth observing that directors should engage in dialogue not only with institutional shareholders, but also with retail shareholders, which account for a significant share of public companies' ownership,²⁴ and, within the context of concentrated ownership, with the company's controlling shareholders.²⁵ Obviously, each shareholder group has its own information needs and the issues raised by each only partly coincide, so dialogue with different types of shareholders calls for different formats. Nevertheless, this article will only focus on engagement with institutional investors,²⁶ which is certainly topical at the moment.²⁷

As mentioned before, the stewardship functions performed by institutional investors are a common feature of listed companies' corporate governance around the world, and empirical evidence suggests that institutional investors are the main target of issuers' engagement strategies.²⁸ Specifically, this article focuses on director-institutional shareholder dialogue that: (i) involves board members, and (ii) occurs outside of shareholders' meetings on a non-recurring basis, whereas director-shareholder exchanges that take place on a regular basis and that are open to all shareholders, like roadshows, lie beyond the scope of this article. In so doing, the article examines dialogue that consists of mutual exchanges of information (i.e. true "dialogue"), as well as one-way communication from the issuer to institutional investors, or *vice-versa*, as happens, for example, in private meetings with a limited number of shareholders willing to communicate their concerns about specific aspects of

²³ Rock, *supra* note 16, at 896 (quoting John Wilcox, *Presentation Outline: Is There a Convergence of Investor Relations and Corporate Governance?* (Jan 19, 2010) (on file with author)).

²⁴ See Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 12–17 (2017); Yaron Nili & Kobi Kastiel, *In Search of 'Absent' Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 66, 68–69 (2016).

²⁵ Within the context of concentrated ownership as is typical in Continental Europe, ongoing dialogue between directors and the company's controlling shareholders has become a main feature of listed companies' corporate governance. For Germany, see Fleischer, *supra* note 16, at 529–540; for Nordic Countries, see Jesper L. Hansen, *The Role of Shareholders in Public Companies in the Nordic Countries*, in GERMAN AND NORDIC PERSPECTIVES ON COMPANY LAW AND CAPITAL MARKETS LAW 81–110 (Holger Fleischer et al. eds., 2015); for Italy, see Giovanni Strampelli, *L'informazione societaria a quindici anni dal T.U.F.: profili evolutivi e problemi*, 5 RIVISTA DELLE SOCIETÀ (RIV. SOC.) 991, 1047–59 (2014) (It).

²⁶ For the purposes of this article the terms institutional investors, institutional shareholders, and relevant shareholders are used as synonyms.

²⁷ See ADVISORY BD. ON CORP./INV'R ENGAGEMENT, THE CONFERENCE BD. GOVERNANCE CTR., *supra* note 15, at 7.

²⁸ See GOLDSTEIN, *supra* note 9, at 24.

the company's governance and strategies to directors, without receiving, in turn, any information from directors.

III. THE FAVORABLE TREND TOWARDS BOARD-SHAREHOLDER DIALOGUE WITHIN A CONTEXT OF ENHANCED INVESTOR ENGAGEMENT

Dialogue between issuers and institutional shareholders is a well established practice. Over the last few years, due to increased calls for engagement from institutional investors, directors have increasingly been engaging in dialogue with those parties.²⁹ The importance of board-institutional shareholder engagement has been acknowledged by the United States Securities and Exchange Commission ("SEC"), as well as under European law.³⁰ Furthermore, both in the United States and in Europe, corporate governance and stewardship codes require institutional investors to increase their stewardship role over portfolio companies.³¹ Similarly, actors in both regions are developing sets of "best practices" in an effort to make the process of director-shareholder engagement more effective and compliant with the existing regulatory framework.³² Against this background, in this section I

²⁹ See, e.g., MORROW SODALI, INSTITUTIONAL INVESTOR SURVEY 2018 16 (2018), <https://www.morrowsodali.com/news/institutional-investor-survey-2018>. See also GOVERNANCE INSIGHTS CTR., PRICEWATERHOUSECOOPERS, THE GOVERNANCE DIVIDE: BOARDS AND INVESTORS IN A SHIFTING WORLD, 2017 ANNUAL CORPORATE DIRECTORS SURVEY 1, 14–15 (2017) [hereinafter PWC 2017 ANNUAL CORPORATE DIRECTORS SURVEY], <https://www.pwc.es/es/publicaciones/consejos-y-buen-gobierno/pwc-2017-annual-corporate-directors-survey.pdf>.

³⁰ See *infra* Part IV. See also Kara S. Stein, Commissioner, U.S. Sec. & Exch. Comm'n, SEC-NYU Dialogue on Securities Market Regulation Concluding Remarks (Jan. 19, 2018) [hereinafter Stein Concluding Remarks], <https://www.sec.gov/news/speech/stein-2018-01-19> (noting that "the relationship between corporations and their shareholders is the bedrock upon which [U.S.] capital markets stand").

³¹ For the U.S., see, e.g., COMMONSENSE PRINCIPLES OF CORPORATE GOVERNANCE 3 (2016), <http://www.governanceprinciples.org>; *Corporate Governance Principles for US Listed Companies*, INV'R STEWARDSHIP GRP., <https://www.isgframework.org/corporate-governance-principles/> (last visited Jan. 8, 2018). For the European Union, see, e.g., EUR. FUND & ASSET MGMT. ASS'N, EFAMA CODE FOR EXTERNAL GOVERNANCE: PRINCIPLES FOR THE EXERCISE OF OWNERSHIP RIGHTS IN INVESTEE COMPANIES 5 (2011) [hereinafter EFAMA CODE], <http://www.efama.org/search/pages/results.aspx/results.aspx?sq=1&k=Code%20For%20External%20Governance>.

³² See, e.g., THE SHAREHOLDER-DIRECTOR EXCHANGE, INTRODUCTION AND SDX PROTOCOL (2014) [hereinafter SDX PROTOCOL], <http://www.sdxprotocol.com/what-is-the-sdx-protocol/>.

provide an overview of the transatlantic favorable trend towards director-institutional investor dialogue.

A. The United States

Board-shareholder dialogue is commonplace in the United States, where it is considered to be an essential tool for engagement by institutional investors.³³ To mention some particularly relevant findings, PricewaterhouseCoopers' 2017 Annual Corporate Directors Survey shows that 42% of the 848 directors interviewed stated that their respective board engaged with investors within the past 12 months,³⁴ although a (decreasing) set of those directors still believed that such dialogue entails certain drawbacks or shortcomings.³⁵ Similarly, a study carried out by Institutional Shareholder Services for the Investor Responsibility Research Center Institute confirmed that the frequency of engagement is continuing to increase, and that directors themselves are more frequently involved in dialogues with shareholders.³⁶

What is more, the most prominent institutional investors have readily confirmed the results of that study and have pushed for additional growth in this area. According to Michelle Edkins, the global head of the investment stewardship team at BlackRock (the world's largest asset manager): "BlackRock strongly supports communication between boards and investors, where it would help build mutual understanding," even though some progress is needed in order to help establish a channel for communication between the board and

³³ See, e.g., IPREO, CORPORATE ACCESS SURVEY 2016 1, (2016), <https://ipreo.com/blog/corporate-access-survey-2016/> (showing that, notwithstanding a decline in the overall numbers of private meetings with investors, the average publicly traded firm conducts more than 100 one-on-one meetings annually with investors).

³⁴ See PWC 2017 ANNUAL CORPORATE DIRECTORS SURVEY, *supra* note 29, at 14. See also GOVERNANCE INSIGHTS CTR., PRICEWATERHOUSECOOPERS, THE SWINGING PENDULUM: BOARD GOVERNANCE IN THE AGE OF SHAREHOLDER EMPOWERMENT, 2016 ANNUAL CORPORATE DIRECTORS SURVEY 1, 11 (2016), <https://www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/assets/pwc-2016-annual-corporate--directors--survey.pdf> (finding that more than half of the 884 directors interviewed stated that their board engaged with investors).

³⁵ See PWC 2017 ANNUAL CORPORATE DIRECTORS SURVEY, *supra* note 29, at 15 (noting that 15% of surveyed directors did not believe that the right investor representatives were present at the meetings, and 21% of the sample was convinced that the board did not receive valuable insights from the engagement).

³⁶ See GOLDSTEIN, *supra* note 9, at 4 (noting that the BlackRock global team engages with approximately 1,500 companies per year on a range of issues). See also Jan Fichtner et al., *Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk*, 19 BUS. & POLITICS 298, 318 (2017).

investors.³⁷ Likewise, during the twelve months prior to June 30, 2016, Vanguard (one of the world's largest asset managers) interacted on more than 800 occasions with the management or directors at companies of different types and sizes, representing nearly \$1 Trillion in Vanguard fund assets.³⁸ F. William McNabb III, Vanguard's Chairman and CEO, has stated that "[t]he relationship between corporate boards and large shareholders is important, but too often, there's precious little communication between the two parties. The case for effective engagement is compelling for both shareholders *and* boards."³⁹

In line with this favorable trend towards board-shareholder engagement, the SEC and a number of corporate governance actors and organizations have drafted recommendations, principles, and guidance concerning board-shareholder dialogue.⁴⁰ I will address each of these more formal actions in turn. First, as for the SEC, in 2010 the Commission provided some interpretive guidance on Regulation Fair Disclosure ("Regulation FD"), the aim of which was to clarify that Regulation FD does not prohibit directors from holding private meetings with shareholders.⁴¹ In addition, SEC Commissioners also appear to be continuously involved in promoting director-shareholder dialogue as an important engagement tool. For example, former SEC Chairman Mary Jo White spoke out in 2013 and 2015 in favor of direct engagement: stating that the board of directors is – or ought to be – a central player in shareholder engagement.⁴²

³⁷ See Nicole Noutsios, *BlackRock Focus on Company-Shareholders Engagement*, IR UPDATE, Sept. 2016, at 10, 12.

³⁸ *Our Proxy Voting and Engagement Efforts: An Update, for the 12 Months Ended June 30, 2016*, VANGUARD, <https://about.vanguard.com/investment-stewardship/update-on-voting/> (last visited Jan. 8, 2018).

³⁹ See Letter from F. William McNabb III, Vanguard's Chairman and CEO, to the independent leaders of the boards of directors of the Vanguard funds' largest portfolio holdings (Feb. 27, 2015), https://about.vanguard.com/investment-stewardship/CEO_Letter_03_02_ext.pdf.

⁴⁰ See generally Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 836 (2013).

⁴¹ *Compliance and Disclosure Interpretations: Regulation FD*, U.S. SEC. & EXCH. COMM'N [hereinafter *Compliance and Disclosure Interpretations*], <http://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm> (last updated June 4, 2010).

⁴² See Mary Jo White, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the 10th Annual Transatlantic Corporate Governance Dialogue 2 (Dec. 3, 2013), <https://www.sec.gov/news/speech/2013-spch110313mjw> ("When shareholders have the ability to scrutinize a company's corporate governance practices, they can help to identify areas of improvement. But, this only happens if the board and management invite shareholder engagement and actively consider the interests of the shareholders they

Second, both the corporate community and institutional investors promoted additional sets of corporate governance principles recommending director-shareholder dialogue in 2016. For example, the Commonsense Principles of Corporate Governance (developed by a group of executives that lead prominent public corporations and investors in the United States) clearly recognized the importance of robust communication of a board's thinking to shareholders.⁴³ Along the same lines, the Investor Stewardship Group ("ISG")—which is made up of thirty-eight American and international institutional investors—has developed a "Framework for U.S. Stewardship and Governance."⁴⁴ The Framework contains a set of stewardship principles for institutional investors and corporate governance principles for American public companies.⁴⁵ ISG's "Corporate Governance Principle No. 3.3" deals with director-shareholder dialogue, stating, "[t]he appropriate independent directors should be available to engage in dialogue with shareholders on matters of significance, in order to understand shareholders' views."⁴⁶ Likewise, "Stewardship Principle E.3" requires institutional investors to communicate clearly, as part of their engagement process, their views and any concerns with a company's practices on governance-related matters.⁴⁷ Companies and investors should identify mutually held objectives and areas of disagreement, and ensure their respective views are understood. What is more, director-shareholder dialogue is also covered by the "Principles of Corporate Governance 2016" promulgated by the Business Roundtable (an organization representing CEOs of leading American companies), pointing out that "[r]egular shareholder outreach and ongoing dialogue are critical to developing and maintaining effective investor relations, understanding the views of

serve."); Mary Jo White, Chairman, U.S. Sec. & Exch. Comm'n, Speech at Society of Corporate Secretaries and Governance Professionals 69th National Conference: Building Meaningful Communication and Engagement with Shareholders 2 (June 25, 2015), <https://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholders.html> ("[C]ompanies should seek to engage in a constructive dialogue with their shareholders and work to facilitate constructive solutions to issues they raise.").

⁴³ See COMMONSENSE PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 31, at 3.

⁴⁴ *About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance*, INV'R STEWARDSHIP GRP., <https://www.isgframework.org/> (last visited Jan. 8, 2018).

⁴⁵ *See id.*

⁴⁶ *Corporate Governance Principles for US Listed Companies*, INV'R STEWARDSHIP GRP., *supra* note 31.

⁴⁷ *Stewardship Framework for Institutional Investors*, INV'R STEWARDSHIP GRP., <https://www.isgframework.org/stewardship-principles/> (last visited Jan. 8, 2018).

shareholders, and helping shareholders understand the plans and views of the board and management.”⁴⁸

Third, around 15 years ago, the National Association of Corporate Directors (“NACD”) established a task force on improving board-shareholder communications.⁴⁹ Since that time, corporate governance experts are ever more involved in developing protocols and guidelines aimed at making board-shareholder engagement valuable and effective. To mention some of the most notable initiatives in this area, in 2014 a working group of leading independent directors and representatives from some of the largest and most influential long-term institutional investors developed sets of guidelines, the Shareholder-Director Exchange Protocol, to provide a framework for shareholder-director engagement.⁵⁰ Likewise, the Conference Board (a research organization active in the area of corporate governance that counts approximately 1,200 public and private corporations and other organizations as members), assisted by its advisory board—a group of governance experts from public corporations, major institutional investors, advisors, and academics—also published its Engagement Guidelines in 2014, which included “examples of communications forms and practices, ways in which both companies and investors can more effectively interact with proxy advisory firms on corporate voting issues, and common steps to prepare for engagement.”⁵¹

B. The European Union

The debate concerning board-shareholder engagement in Europe was initiated by the European Commission’s Action Plan on European Company Law and Corporate Governance,⁵² which resulted in the subsequent proposal of a directive reforming the Shareholders Rights Directive of 2007.⁵³ The first draft of the amending directive included provisions concerning director-

⁴⁸ BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE 25 (2016), <http://businessroundtable.org/corporate-governance>.

⁴⁹ THE NAT’L ASS’N OF CORP. DIRS. & THE COUNCIL OF INSTITUTIONAL INV’RS, FRAMEWORK AND TOOLS FOR IMPROVING BOARD-SHAREHOLDER COMMUNICATIONS 2 (2004), www.sec.gov/rules/proposed/s71903/nacd030904-attach.pdf.

⁵⁰ See SDX PROTOCOL, *supra* note 32. See also Mallow & Sethi, *supra* note 8, at 401–02.

⁵¹ See ADVISORY BD. ON CORP./INV’R ENGAGEMENT, THE CONFERENCE BD. GOVERNANCE CTR., *supra* note 15, at 3.

⁵² Action Plan on European Company Law, *supra* note 5.

⁵³ See *Commission Proposal for a Directive of the European Parliament and of the Council Amending Directive 2007/36/EC as Regards the Encouragement of Long Term Shareholder Engagement and Directive 2013/34/EU as Regards Certain Elements of the Corporate Governance Statement*, COM (2014) 213 final (Apr. 9, 2014).

institutional shareholder dialogue, which have been maintained in the final text of Directive 2017/828/EU amending Directive 2007/36/EC with respect to the encouragement of long-term shareholder engagement (hereinafter “SHRD II”).⁵⁴ Recital 16 to SHRD II emphasizes that:

Institutional investors and asset managers are often not transparent about their investment strategies, their engagement policy and the implementation thereof. Public disclosure of such information could have a positive impact on investor awareness, enable ultimate beneficiaries such as future pensioners, optimize investment decisions, facilitate the dialogue between companies and their shareholders, encourage shareholder engagement and strengthen their accountability to stakeholders and to civil society.⁵⁵

Specifically, Article 3g of SHRD II provides that institutional investors and asset managers shall, under a comply-or-explain rule, develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement into their investment strategy.⁵⁶ The policy, among other things, shall describe how institutional investors and asset managers “conduct dialogues with investee companies.”⁵⁷ Article 3j of SHRD II further requires proxy advisors to disclose on an annual basis, among other things, “whether they have dialogues with the companies which are the object of their research, advice or voting recommendations and with the stakeholders of the company, and, if so, the extent and nature thereof.”⁵⁸

The provisions laid forth in SHRD II are relevant insofar as they confirm that European Union (“EU”) law favors dialogue between companies and their

⁵⁴ See SHRD II, *supra* note 6.

⁵⁵ *Id.* at 3.

⁵⁶ *Id.* at 16.

⁵⁷ *Id.* Another reference to director-shareholder dialogue is included in Recital 49 of the SHRD II, which recognizes that shareholders and investors can engage with the company on the implementation of the remuneration policy. Due to the introduction of the “say-on-pay” vote executive compensation is a privileged area of engagement both in the US and in Europe. See generally Randall S. Thomas et al., *Dodd-Frank’s Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213, 1256 (2012) (“The say-on-pay votes mandated by Dodd-Frank, in these commentators’ eyes, appear to have catalyzed greater management attention to shareholder concerns, an increased shareholder interest in voting on corporate governance, and a broader dialogue on pay issues between management and shareholders (and proxy advisory firms).”); Yockey, *supra* note 22, at 214–18.

⁵⁸ SHRD II, *supra* note 6, at 18.

shareholders, and promotes shareholder engagement by choosing a comply-or-explain mechanism. Nevertheless, within the EU regulatory framework, board-institutional shareholder dialogue in general is still regulated by stewardship and corporate governance codes adopted at the national level, which provide companies and their shareholders with detailed guidelines on how to conduct director-shareholder dialogue.⁵⁹ As is made clear in the introductory notes to the UK Stewardship Code, corporate governance codes target companies and boards, while stewardship codes set out principles of effective stewardship by investors.⁶⁰

Director-shareholder dialogue is widely recognized as an important means of engagement in all main stewardship codes. The UK Stewardship Code states that, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example by meeting with the chair or other board members.⁶¹ The Code for External Governance from the European Fund and Asset Management Association (the “EFAMA Code”) includes a similar recommendation.⁶² Institutional investors should interact with investee companies on an ongoing basis in order to protect and secure value over the long term.⁶³ Initial discussions can entail, for example, meeting with the Chief Executive Officer, Senior Independent Director, or the Chair of the Supervisory Board, as the case may be, or with other independent directors or board members.⁶⁴ More generally, when investors have concerns about the company’s strategy and performance, the EFAMA Code recommends that they should seek to ensure that the appropriate members of an investee company’s board are made aware of them.⁶⁵

⁵⁹ See Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 10–14 (2011) (outlining that corporate governance codes represent, across several countries, a building block for the corporate governance regulatory framework).

⁶⁰ UK STEWARDSHIP CODE, *supra* note 4, at 1.

⁶¹ *Id.* at 5.

⁶² EFAMA CODE, *supra* note 31. The EFAMA CODE played a major role in developing board-shareholder engagement at the EU level by inspiring some stewardship codes adopted at national level. See, e.g., ASSOGESTIONI, ITALIAN STEWARDSHIP PRINCIPLES (2016) [hereinafter ITALIAN STEWARDSHIP PRINCIPLES 2016], <http://www.assogestioni.it/index.cfm/1.815.0.49.html/principi-italiani-di-stewardship> (“The adopted Principles are inspired by those contained in the EFAMA Code for External Governance, approved by the European Fund and Asset Management Association, of which Assogestioni is a member.”).

⁶³ EFAMA CODE, *supra* note 31, at 5.

⁶⁴ *Id.*

⁶⁵ *Id.* at 4.

As far as issuers are concerned, the provisions of corporate governance codes dealing with director-shareholder dialogue are fundamental. Section E of the UK Corporate Governance Code recommends that “[t]here should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.”⁶⁶ The same section also states, in general terms, that “the board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.”⁶⁷

Provisions similar to those contained in the UK Corporate Governance Code can be found in corporate governance codes adopted in other EU Member States. For example, the Belgian Code on Corporate Governance recommends that “the board should take the necessary measures to encourage shareholders, and in particular institutional shareholders, to play an important role in carefully evaluating a company’s corporate governance,”⁶⁸ and requires issuers to put in place a disclosure and communication policy promoting an effective dialogue with shareholders and potential shareholders.⁶⁹ The Danish Recommendations on Corporate Governance are modeled along the same lines,⁷⁰ requiring the board to ensure a continuous dialogue between the company and its shareholders “in order for the shareholders to gain relevant insight into the company’s potential and policies, and in order for the board of directors to be aware of the shareholders’ views, interests, and opinions regarding the company.”⁷¹ Director-shareholder dialogue is also recommended

⁶⁶ FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE § E, at 22–23 (2016) [hereinafter UK CORPORATE GOVERNANCE CODE], <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>.

⁶⁷ *Id.*

⁶⁸ CORP. GOVERNANCE COMM., THE BELGIAN CODE ON CORPORATE GOVERNANCE § 8.12, at 25 (2009) [hereinafter BELGIAN CODE ON CORPORATE GOVERNANCE], <http://www.corporategovernancecommittee.be/en/about-2009-code/2009-belgian-code-corporate-governance>.

⁶⁹ *Id.* (§ 8.13 further recommends that the board “should endeavour to ensure that institutional and other shareholders weigh up all relevant factors drawn to their attention.” Moreover, “[t]he board should engage in a dialogue with shareholders if those shareholders do not accept the company’s position, bearing in mind in particular the company’s size and complexity and the nature of the risks and challenges it faces.”).

⁷⁰ COMM. ON CORP. GOVERNANCE, RECOMMENDATIONS ON CORPORATE GOVERNANCE para. 1.1.1. (2017) [hereinafter DANISH RECOMMENDATIONS ON CORPORATE GOVERNANCE], <https://corporategovernance.dk/english>.

⁷¹ *Id.* (“The company’s dialogue with its shareholders may be summarised in an Investor Relations strategy on the type of information to be published, the language to be used, as well as how, when and to whom this should be published. The strategy should also relate to selection and attraction of investor target groups.”).

under the Italian Corporate Governance Code, according to which “it is in the best interests of the issuers to establish an ongoing dialogue with shareholders in general and with institutional investors in particular, in accordance with rules and procedures governing the disclosure of price-sensitive information.”⁷²

Director-shareholder dialogue has been particularly discussed amongst German scholars and practitioners.⁷³ The debate focuses on dialogue between shareholders and the supervisory board (*Aufsichtsrat*), since closer engagement with the supervisory board is considered to be crucial in allowing institutional investors to perform an active role in the monitoring of listed companies.⁷⁴ The Guiding Principles for Dialogue Between Investors and German Supervisory Boards, which were drafted by a group comprised of academics as well as representatives of issuers and institutional investors, were published in 2016.⁷⁵ In addition, an update of the German Corporate Governance Code (Deutscher Corporate Governance Kodex) was approved in February 2017.⁷⁶ The revised version of the Code includes a new “suggestion,”⁷⁷ according to

⁷² CORP. GOVERNANCE COMM., CORPORATE GOVERNANCE CODE § 9 (2015) [hereinafter ITALIAN CORPORATE GOVERNANCE CODE], <http://www.borsaitaliana.it/borsaitaliana/regolamenti/corporategovernance/corporategovernance.en.htm>.

⁷³ See Hopt, *supra* note 7, at 4–6 (“The reactions to the new suggestions of the Code (and the Guiding Principles) have been mixed. The institutional investors and large corporations as well as portions of the financial press and academia approved of them. Others, in particular other corporations, lawyers and traditional academia, criticized them, some very harshly.”).

⁷⁴ *Id.*

⁷⁵ GER. INV. FUNDS ASS’N, GUIDING PRINCIPLES FOR DIALOGUE BETWEEN INVESTORS AND GERMAN SUPERVISORY BOARDS (2016), https://www.bvi.de/fileadmin/user_upload/news/2016_07_11_Guiding_Principles_for_Shareholder_Communications_with_Supervisory_Board.pdf.

⁷⁶ REGIERUNGSKOMMISSION, DEUTSCHER CORPORATE GOVERNANCE KODEX (2017) [hereinafter GERMAN CORPORATE GOVERNANCE CODE], <http://www.dcgk.de/en/code.html>.

⁷⁷ See Hopt, *supra* note 7, at 5 (“The original proposal of the Commission went further than the present version in one important point. The Code distinguishes sharply between ‘shall’ (‘soll’), as found in the proposal, and ‘should’ (‘sollte’), as found in the present version. The first case this would have been a ‘recommendation’ which, while of course not binding, would nevertheless have required that any deviation from it must be disclosed under § 161 of the Stock Corporation Act. The present version has been softened to a mere ‘suggestion,’ which the board might consider but which it can drop without further ado and without having to disclose this fact.”). In fact, as explained by the introductory notes of the GERMAN CORPORATE GOVERNANCE CODE, recommendations of the Code are indicated in the text by using the word “shall.” Corporations may depart from recommendations, but in this case they are obliged to disclose and explain any departures each year. This enables corporations to reflect sector- or company-specific requirements. Well-justified departures from recommendations of the Code may be in the best interests of good corporate governance. Thus, the Code contributes to greater flexibility and more

which “[t]he Supervisory Board Chair should be available—within reasonable limits—to discuss Supervisory Board-related issues with investors.”⁷⁸

In conclusion, an overview of the U.S. and European regulatory frameworks clearly shows that private dialogue between directors and shareholders is a common (and progressively growing) practice on the both sides of the Atlantic. Moreover, it is strongly recommended by both legislatures and corporate governance best practices as an important tool for institutional investor engagement.

IV. LEGAL CONSTRAINTS ON BOARD-SHAREHOLDER ENGAGEMENT: THE MATERIALITY THRESHOLD

In spite of the favorable trend towards recognizing director-institutional investor dialogue as an essential element of the system of corporate governance for listed companies, issuers and investors have voiced concerns about the economic and legal impediments to engagement. Among the economic impediments: time and resource constraints, along with an “unwillingness to talk,” seem to be of primary importance.⁷⁹ From the legal standpoint: director-shareholder dialogue can cause non-public information to be selectively disclosed, and it is therefore necessary to ensure compliance with Regulation FD⁸⁰ in the U.S. Similarly, the market abuse regime and the principle of equal treatment have been the main sources of constraint for dialogue within the European legal framework.⁸¹ This part will consider the legal constraints on board-shareholder dialogue, and show that their role should not be overstated.

self-regulation in the German corporate constitution. Additionally, the Code contains suggestions from which corporations may depart without disclosure; suggestions are indicated in the text by using the word “should.” The remaining passages of the Code that do not use these words relate to descriptions of statutory requirements and explanations.

⁷⁸ GERMAN CORPORATE GOVERNANCE CODE, *supra* note 76, at 9. The recommendation adopted in the final version of the revised GERMAN CORPORATE GOVERNANCE CODE is shorter than that included in an earlier draft of October 2016, according to which “under appropriate conditions, the Chairman of the Supervisory Board shall be prepared to engage into discussions with investors on Supervisory Board-related topics. These are items resting in the sole responsibility of the Supervisory Board thus exclusively to be decided by the latter. Discussions on aspects, which are to be decided jointly by the Management Board and the Supervisory Board, shall be led solely by the Management Board or by the Chairman of the Supervisory Board together with the Management Board.” REGIERUNGSKOMMISSION, PROPOSED REVISED DEUTSCHER CORPORATE GOVERNANCE KODEX 10 (2016).

⁷⁹ See GOLDSTEIN, *supra* note 9, at 29–31.

⁸⁰ Regulation FD, 17 C.F.R. § 243 (2017).

⁸¹ See *id.* See also Fairfax, *supra* note 40, at 834–38; Yockey, *supra* note 22, at 205–14.

Such constraints only apply to the communication of material non-public information and thus do not hinder dialogue that does not reach the threshold of materiality, as long as such communication does not involve inside information. When performing their stewardship functions, institutional investors are primarily interested in communicating their views, or concerns, to investee companies. They do not wish to receive material non-public information, so as to ensure that they can freely trade securities issued by investee companies.

A. The compatibility of director-shareholder dialogue that does not concern material information with Regulation FD

Regulation FD addresses selective disclosure to investors and analysts by providing that, where an issuer, or a person acting on its behalf, selectively discloses material non-public information to certain enumerated persons, the issuer must make public disclosure of that information.⁸² The SEC adopted Regulation FD due to concerns regarding the effective ability of insider trading law to establish liability for an issuer's selective disclosure.⁸³ In fact, given the potential effect on the integrity of financial markets,⁸⁴ the SEC became increasingly concerned about selective disclosures of material non-public information, such as advance warnings of earnings results communicated to securities analysts, selected institutional investors, or both, before the full disclosure of such information to the general public.⁸⁵ The SEC remarked that:

⁸² Regulation FD, 17 C.F.R. § 243.100 (2017).

⁸³ Marc I. Steinberg, *Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis*, 22 U. PA. J. INT'L ECON. L. 635, 649 (2001); Yockey, *supra* note 22, at 208.

⁸⁴ See Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881, Exchange Act Release No. 34-43154, Investment Company Act Release No. IC-24599, 2000 WL 1201556, at II(A) (Aug. 15, 2000) [hereinafter Exchange Act Release No. 43154] ("Regulation FD is also designed to address another threat to the integrity of our markets: the potential for corporate management to treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors. As noted in the Proposing Release, in the absence of a prohibition on selective disclosure, analysts may feel pressured to report favorably about a company or otherwise slant their analysis in order to have continued access to selectively disclosed information. We are concerned, in this regard, with reports that analysts who publish negative views of an issuer are sometimes excluded by that issuer from calls and meetings to which other analysts are invited.?).

⁸⁵ See Solomon & Soltes, *supra* note 9, at 353 ("Selective access to management that leads to more advantageous trading is inconsistent with the notion of a level playing field with regard to information that the SEC sought to create.?).

[w]here this has happened, those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those kept in the dark. We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.⁸⁶

Therefore, quite obviously, the scope of Regulation FD directly covers director-shareholder dialogue.⁸⁷ Regulation FD, in fact, prohibits an issuer, or persons acting on a company's behalf,⁸⁸ from selectively disclosing material inside information regarding such company or its securities to certain enumerated persons most likely to receive and trade on the improper selective disclosure. Namely, Sections 243.100(b)(1)(i)-(iv) enumerate four categories of persons to whom selective disclosures may not be made absent a specified exclusion: a broker or dealer, or a person associated with a broker or dealer; an investment adviser, an institutional investment manager, or a person associated with either; an investment company or affiliated person thereof; and "a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information."⁸⁹ Any material non-public information regarding that issuer or its securities selectively disclosed to these persons shall be made public "(1) [s]imultaneously, in the case of an intentional disclosure; and (2) [p]romptly, in the case of a non-intentional disclosure."⁹⁰

As shareholders are explicitly included within its scope, Regulation FD has an impact on investor relations functions⁹¹ and on board-shareholder

⁸⁶ Exchange Act Release No. 43154, *supra* note 84, at II(A).

⁸⁷ See BUSINESS ROUNDTABLE, *supra* note 48, at 25 ("Communications with shareholders are subject to applicable regulations (such as Regulation Fair Disclosure) and company policies on confidentiality and disclosure of information.").

⁸⁸ Regulation FD defines a "person acting on behalf of an issuer" as "any senior official of the issuer [...] or any other officer, employee, or agent of an issuer who regularly communicates with any person described in Sections 243.100(b)(1)(i), (ii), (iii), or with holders of the issuer's securities." Moreover, a "Senior Official" means any director, executive officer, investor relations or public relations officer, or other person with similar functions. See Regulation FD, 17 C.F.R. § 243.101(c) (2017).

⁸⁹ Regulation FD, 17 C.F.R. § 243.100(b)(1)(i)-(iv) (2017).

⁹⁰ Regulation FD, 17 C.F.R. § 243.100(a) (2017).

⁹¹ See generally Rock, *supra* note 16, at 871-73 (pointing out that Regulation FD "had a substantial impact on how investor relations professionals performed their work").

engagement.⁹² However, in spite of conventional wisdom that Regulation FD can ban private director-shareholder meetings, experts suggest that corporate concerns related to Regulation FD should not be exaggerated, as has been acknowledged by the SEC itself.⁹³

In 2010, the SEC issued interpretive guidance on Regulation FD with the aim of mitigating concerns that had been raised in relation to its scope.⁹⁴ The SEC made it clear that Regulation FD does not prohibit director-shareholder dialogue, provided that some precautionary procedures are followed.⁹⁵ According to the SEC, “because Regulation FD does not apply to disclosures made to a person who expressly agrees to maintain the disclosed information in confidence, a private communication between an independent director and a shareholder would not present Regulation FD issues if the shareholder provided such an express agreement.”⁹⁶

The SEC also excludes “ordinary-course business-related communications” with parties such as customers, suppliers, strategic partners, and government regulators from the scope of application of Regulation FD.⁹⁷ What is more, the SEC provides a list of some types of information or events that should be reviewed carefully to determine whether they are material. Precisely, the list includes:

- (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers; (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no

⁹² See Yockey, *supra* note 22, at 206 (“[T]he degree to which directors may freely disclose information during the course of negotiations is substantially limited by the SEC’s Regulation FD.”).

⁹³ See, e.g., Fairfax, *supra* note 40, at 834–36; Rock, *supra* note 16, at 871, 898 (noting that Regulation FD “is beside the point”). See also BUSINESS ROUNDTABLE, *supra* note 48, at 25.

⁹⁴ See generally *Compliance and Disclosure Interpretations*, *supra* note 41.

⁹⁵ See *infra* Part V.

⁹⁶ *Compliance and Disclosure Interpretations*, *supra* note 41, at 101.11. On the limited attractiveness of such an agreement, see Yockey, *supra* note 22, at 213 (“However, such agreements are often unattractive to shareholders because they would seemingly need to be asked to sign them without learning the nature of the information to be disclosed.”). For active institutional shareholders also, the promise to not trade seems unattractive because of its incompatibility with their business model.

⁹⁷ Exchange Act Release No. 43154, *supra* note 84, at II(A)(4).

longer rely on an auditor's audit report; (6) events regarding the issuer's securities; and (7) bankruptcies or receiverships.⁹⁸

Thus, topics more likely to be discussed in board-shareholder private meetings—such as “succession planning, executive compensation, director nominating criteria, governance philosophies, and general board oversight (including of accounting, internal controls, risk, auditing and other related matters)”⁹⁹—are not included by the SEC among information or events that have an increased potential to be deemed material. Therefore, as Professor Fairfax notes, there is a reduced likelihood that the information about which shareholders are most concerned will run afoul of Regulation FD.¹⁰⁰

The history of Regulation FD enforcement also supports the view that director-shareholder dialogue is unlikely to violate Regulation FD. In fact, since its adoption in October 2000, the SEC has not brought any Regulation FD enforcement action based on communications or disclosures associated with shareholder-director engagement.¹⁰¹ Furthermore, as a matter of fact, institutional shareholders usually request that advance checks be carried out to ensure that they do not receive any material non-public information through contact with directors, in order to avoid prohibitions on trading the company's securities under insider trading law.¹⁰²

⁹⁸ SEC, WRITTEN STATEMENT CONCERNING REGULATION FAIR DISCLOSURE (May 17, 2001), www.sec.gov/news/testimony/051701wssec.htm#P7817603.

⁹⁹ See SDX PROTOCOL, *supra* note 32, at 13 (noting that such topics “do not typically rise to the level of materiality commonly understood to be important to an investor making an investment decision and otherwise significantly alter the total mix of information available.”).

¹⁰⁰ See Fairfax, *supra* note 40, at 836 (citing STEPHEN DAVIS & STEPHEN ALOGNA, MILLSTEIN CENTER FOR CORPORATE GOVERNANCE AND PERFORMANCE, TALKING GOVERNANCE: BOARD-SHAREHOLDER COMMUNICATIONS ON EXECUTIVE COMPENSATION 10 (2008)).

¹⁰¹ *Id.* (“Studies reveal less than ten Regulation FD enforcement actions, and no enforcement action or investigation related to companies that have had or are planning to have private meetings with shareholders.”).

¹⁰² See F. William McNabb III, *Getting to Know You: The Case for Significant Shareholder Engagement*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 24, 2015), <https://corpgov.law.harvard.edu/2015/06/24/getting-to-know-you-the-case-for-significant-shareholder-engagement/> (“[L]arge shareholders are not looking for inside information on strategy or future expectations. What they’re looking for is the chance to provide the perspective of a long-term investor. Companies individually have to decide how to best manage that risk, but it shouldn’t be by shutting out the shareholders completely.”). With reference to the European context, see UK STEWARDSHIP CODE, *supra* note 4, at 7 (“Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.”). See also EUR. CONFEDERATION OF DIRECTORS’ ASS’NS & INT’L FIN. CORP., A GUIDE TO CORPORATE

In the course of dialogue with directors, it may well be the case that shareholders receive non-material, non-public information that, when combined with further information in the public domain, can result in their gaining an informational advantage over other investors. However, even in such cases, Regulation FD does not prohibit the use of this type of information. The SEC has made it clear that “an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a ‘mosaic’ of information that, taken together, is material.”¹⁰³

In addition, while Regulation FD imposes a disclosure obligation on issuers, it does not prohibit shareholders from receiving the (material) information.¹⁰⁴ Regulation FD covers the disclosure of all material non-public information, even if the recipient of the information does not use it in order to trade the company’s shares.¹⁰⁵ Therefore, action can only be taken against the recipient under the insider trading framework provided for by Section 10(b) of the Securities Exchange Act of 1934,¹⁰⁶ and by Rule 10b-5,¹⁰⁷ when, according to the “personal benefit” test laid down in the Supreme Court’s *Dirks* decision, the person providing the information is motivated by a desire to benefit

GOVERNANCE PRACTICES IN THE EUROPEAN UNION 1, 58 (2015), http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/guidelines_reviews+and+case+studies/a+guide+to+corporate+governance+practices+in+the+european+union (“It is rare in these discussions for anyone other than the CEO to commit the company or to transmit price-sensitive information, because the shareholders are communicating with the directors rather than vice versa.”).

¹⁰³ Exchange Act Release No. 43154, supra note 84, at II(B)(2). See Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PA. L. REV. 801, 809 (2014) (“[I]nsiders can profit legally by trading on many types of valuable, ‘sub-material’ information.”). In the context of Regulation FD, a violation can only occur when the issuer knows that information he provides will complete the mosaic. See, e.g., Brian K. Barry, *The Securities and Exchange Commission’s Regulation Fair Disclosure: Parity of Information or Parody of Information?*, 56 U. MIAMI L. REV. 645, 658–59 (2002) (“[T]he issuer could run afoul of Regulation FD if one of the issuer’s FD-covered personnel knowingly provides the last immaterial piece of the puzzle.”).

¹⁰⁴ See Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 FORDHAM J. CORP. & FIN. L. 33, 75 (2017) (“Reg. FD is aimed at curbing the supply of selectively disclosed information, not demand. Reg. FD will consequently not prevent investors from trying to obtain the most value-relevant information possible.”).

¹⁰⁵ Susan B. Heyman, *Rethinking Regulation Fair Disclosure and Corporate Free Speech*, 36 CARDOZO L. REV. 1099, 1109 (2015) (“Although subsequent trading is evidence of materiality, the SEC does not need to prove that any trading occurred in order to establish a violation of Reg FD.”).

¹⁰⁶ 15 U.S.C. § 78j(b) (2012).

¹⁰⁷ 17 C.F.R. § 240.10b-5 (2017).

personally from the selective disclosure,¹⁰⁸ or when the misappropriation theory may be invoked.¹⁰⁹

Ultimately, it does not seem to be too far from the truth to state that Regulation FD can reasonably be regarded as more a “crutch” for issuers to avoid engagement with shareholders¹¹⁰ than an actual impediment on director-shareholder dialogue.¹¹¹

B. The impediment on director-shareholder dialogue concerning inside information posed by the principle-of-equal-information-based EU Market Abuse Regulation

As mentioned above, due to its approach to insider trading based on the principle of equal access to information (which requires firms to simultaneously provide all investors with the same material information),¹¹² the European market abuse regime provided for under the European Parliament’s Market Abuse Regulation (the “MAR”) seems to place a strict constraint on director-institutional shareholder engagement.

Consistent with the parity of information principle, Article 17 of the MAR sets out an issuers’ obligation to promptly disclose inside information—

¹⁰⁸ *Dirks v. SEC*, 463 U.S. 646, 657–58 (1983).

¹⁰⁹ *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (“The ‘misappropriation theory’ holds that a person commits fraud ‘in connection with’ a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.”).

¹¹⁰ *Fairfax*, *supra* note 40, at 836.

¹¹¹ *Yockey*, *supra* note 22, at 210.

¹¹² The main role played by this principle very clearly proceeds from the market abuse regime set out by the European Parliament’s Market Abuse Regulation (the “MAR”) and, namely, from Recital to the 24 MAR which explicitly states that “[t]he question whether a person has infringed the prohibition on insider dealing or has attempted to commit insider dealing should be analyzed in the light of the purpose of this Regulation, which is to protect the integrity of the financial market and to enhance investor confidence, which is based, in turn, on the assurance that investors will be placed on an equal footing and protected from the misuse of inside information.” MAR, *supra* note 13, at 5. *See also* Lars Klöhn, *The European Insider Trading Regulation after Spector Photo Group*, 7 EUR. COMPANY & FIN. L. REV. 347, 358–59 (2010) (noting that principle of equal access to information has different aspects. First, there is an aspect of “geographic” equality in the concept of equal access, that is, investors from different member states should have equal access to price-relevant information. Second, there could be an aspect of “professional” equality, under which no class of investors – such as professional investors – shall have privileged access to information. Third, there is an aspect of “chronological” equality, provided that no investor shall have access to inside information before the other).

whether or not it has been previously communicated to someone else,¹¹³ stating that “[a]n issuer shall inform the public as soon as possible of inside information which directly concerns that issuer.”¹¹⁴ Article 7 of the MAR defines inside information as:

information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.¹¹⁵

The rationale underlying the mandatory disclosure rule is clearly presented in Recital 49 to the MAR, according to which issuers are required to inform the public as soon as possible of any inside information because “the public disclosure of inside information by an issuer is essential to avoid insider dealing and ensure that investors are not misled.”¹¹⁶

The European market abuse regime seems to be adverse to board-shareholder engagement in another respect as well. Article 8 of the MAR lays down an absolute prohibition on insider dealing, according to which inside information cannot be used in “acquiring or disposing of, for its own account

¹¹³ By contrast, in the U.S., Regulation FD requires full disclosure of material information only when material information is disclosed to any person described in § 243.100(b)1. *See* Regulation FD, 17 C.F.R. § 243.100(a) (2017). *See also* Marco Ventoruzzo, *Comparing Insider Trading in the United States and in the European Union: History and Recent Developments*, 11 EUR. COMPANY & FIN. L. REV. 554, 571 (2014) (highlighting that there is not a similar general duty to disclose all material information under US law and this feature of the American system can be pointed out as a major comparative difference with the current European approach). However, the SEC requires issuers to disclose, by filing Form 8-K, ‘on a rapid and current basis’ material information regarding a wide list of events. Thus, the distinction between U.S. and EU regime is in practice less significant than might at first seem. *See, e.g.*, JOHN ARMOUR ET AL., *PRINCIPLES OF FINANCIAL REGULATION* 175–76 (2016) (“The distinction between the two regimes at first blush appears to be that the U.S. mandates ongoing disclosure in relation to any of a specified list of events, whereas the EU does not specify the events which trigger disclosure, rather looking to the consequence of events on the stock price. However, the distinction in practice may be rather more modest.”).

¹¹⁴ MAR, *supra* note 13, at 34.

¹¹⁵ *Id.* at 24.

¹¹⁶ Ventoruzzo, *supra* note 113, at 581–82 (“The default rule in Europe, therefore, is that inside information should be promptly disclosed to the market. This is interesting because it suggests that European law does not accept the principle that inside information belongs to the issuer and can be misappropriated by insiders, but rather that it ‘belongs’ to all investors and, as a general matter, should be shared with the investing public.”).

or for the account of a third party, directly or indirectly, financial instruments to which that information relates.”¹¹⁷ This rule applies to any person who possesses inside information as a result of:

- (a) being a member of the administrative, management or supervisory bodies of the issuer or emission allowance market participant; (b) having a holding in the capital of the issuer or emission allowance market participant; (c) having access to the information through the exercise of an employment, profession or duties; or (d) being involved in criminal activities.¹¹⁸

Article 8 “also applies to any person who possesses inside information under circumstances other than those referred to in the first subparagraph where that person knows or ought to know that it is inside information.”¹¹⁹

In contrast to the analogous regulations in the United States, Article 8 of the MAR makes it clear that the European Union insider trading regime does not require that there be a fiduciary or fiduciary-like relationship, or a duty of trust or confidence, between the source of the information and the recipient of the information. Pursuant to the theory of equal access to information, the prohibition on trading on the basis of material non-public information set out by the MAR is absolute in nature, irrespective of how such information is obtained.¹²⁰ According to Article 8(3) of the MAR, in order to enforce the rules on insider trading it is only necessary to demonstrate that the recipient of the information knows, or ought to know, that the information constitutes inside information.¹²¹

Thus, the European insider trading regime seems to be more restrictive than its U.S. equivalent, and it appears that the general prohibition against trading on the basis of material non-public information laid down by Article 8 of the MAR can have a significant impact on dialogue between directors and institutional shareholders. Specifically, the stricter European regime may

¹¹⁷ MAR, *supra* note 13, at 25.

¹¹⁸ *Id.* at 26.

¹¹⁹ *Id.*

¹²⁰ Sergio Gilotta, *The Regulation of Outsider Trading in EU and the US*, 13 EUR. COMPANY & FIN. L. REV. 631, 638 (2016) (“EU law does not make all the subtle distinctions that the US legal system makes and takes a sharp egalitarian stance toward informed trading by outsiders. It prohibits all trading that is carried out on the basis of material non-public information, without giving much relevance as to whether the trader qualifies as an insider or an outsider, or how precisely he obtained the information.”).

¹²¹ MAR, *supra* note 13, at 26.

discourage institutional investors from engaging with directors, as they are actually faced with a double risk. First, the prohibition in Article 8 of the MAR on trading usually represents an unacceptable burden for active institutional investors, whose business model is based on the ability to trade. Second, under the European market abuse regime, shareholders that engage with directors face the risk of being fined even if they asked not to receive inside information, or if they are not actually aware of having received inside information. Engaging in dialogue with directors could (at least at first glance) turn out to be a dangerous practice for shareholders in Europe.

However, concerns related to the regulations set out in the MAR should not be overstated. Rather, Recital 19 to the MAR clearly affirms that “[t]his Regulation is not intended to prohibit discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer. Such relationships are essential for the efficient functioning of markets and should not be prohibited by this Regulation.”¹²²

In fact, in spite of the general provisions of Articles 8 and 17 of the MAR, the EU market abuse regime seems to leave room for director-shareholder dialogue, without exposing directors and shareholders to the risk of infringing insider trading prohibitions and public disclosure obligations. Therefore, the differences between the U.S. and the European regulatory frameworks governing director-shareholder dialogue should not be considered to be as significant as they might appear at first glance.

First of all, the duty to disclose set out by Article 17(1) of the MAR is not absolute. Article 17(8) of the MAR allows for selective disclosure according to rules comparable to those outlined in Regulation FD,¹²³ stating that:

[w]here an issuer...or a person acting on its behalf or for its account, discloses any inside information to any third party in the normal course of the exercise of an employment, profession or duties as referred to in Article 10(1),¹²⁴ they must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure, and promptly in the case of a non-intentional disclosure. [However,] [t]his paragraph shall not apply if the

¹²² *Id.* at 4.

¹²³ See Yockey, *supra* note 22. See also *supra* text accompanying note 96.

¹²⁴ See MAR, *supra* note 13, at 27 (“For the purposes of this Regulation, unlawful disclosure of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties.”).

person receiving the information owes a duty of confidentiality, regardless of whether such duty is based on a law, on regulations, on articles of association, or on a contract.¹²⁵

Contrary to what might appear at a very first sight, and also based on the opinion of the European Court of Justice (“ECJ”), Article 10 of the MAR does not prohibit dialogue between directors and selected institutional investors. The ECJ Grand Chamber’s decision in the Grøngaard and Bang case held that the selective disclosure exemption laid down by Article 10 of the MAR must be strictly interpreted,¹²⁶ stating that “information is only considered to have been disclosed in the normal course of the exercise of an employment, profession, or duties where there is a close link between the disclosure and the exercise of the recipient’s employment, profession or duties, and that disclosure is strictly necessary for the exercise of that employment, profession or duties.”¹²⁷ Thus, under the decision in Grøngaard and Bang, it is unclear whether the disclosure of inside information to key shareholders falls within the scope of the exemption provided for under Article 10 of the MAR.

However, when interpreting the exemption, it must be considered that Recital 19 to the MAR clearly favors director-shareholder engagement. As one scholar has recently observed, “[a] too narrow interpretation of the exemption in Art[icle] 10 [of the] MAR runs the risk of preventing active engagement by shareholders and should be avoided, where the selective disclosure is reasonable and made in orderly circumstances whereby the circle of recipients is known.”¹²⁸

Furthermore, pursuant to Article 17(8) of the MAR, directors are allowed to disclose selectively material non-public information to recipients who have signed a confidentiality agreement.¹²⁹ If the recipient enters into such an

¹²⁵ *Id.* at 36.

¹²⁶ Case C-384/02, *Criminal proceedings against Knud Grøngaard and Allan Bang*, EU:C:2005 [hereinafter *Grøngaard*], at para. 27 (“Even if that rule, having regard to the terms used, is capable of covering very different situations, it must, as an exception to a general prohibition and in the light of the objective pursued by Directive 89/592, be interpreted strictly.”). See, e.g., Jesper L. Hansen, *Market Abuse Case Law – Where Do We Stand With MAR?*, 14 EUR. COMPANY & FIN. L. REV. 367, 373, 375 (2017); Stefano Lombardo & Federico M. Mucciarelli, *Market soundings: The Interaction Between Securities Regulation and Company Law in the United Kingdom and Italy* 6 (ECGI, Law Working Paper No. 362/2017, 2017), http://ssrn.com/abstract_id=3012183.

¹²⁷ See Grøngaard, *supra* note 126, at para 31, 48.

¹²⁸ Hansen, *supra* note 126, at 374–75.

¹²⁹ See MAR, *supra* note 13, at 36.

agreement, he or she is subject to the prohibition on trading laid down by Article 8 of the MAR, and cannot use any inside information in his or her possession.¹³⁰ Thus, per Article 10, when institutional investors agree to keep the information received confidential, and not to trade on the basis of such information, directors are allowed to freely engage in dialogue with them and to disclose material non-public information.

Nevertheless, the confidentiality-based exemption under Article 10 of the MAR could at first glance appear to be quite unattractive for active institutional investors, who usually want to maintain the ability to exit their positions in investee companies. According to Article 10 of the MAR, a recipient of selective inside disclosures is definitely subject to the prohibition on trading the securities to which the inside information refers. The selective disclosure regime could therefore discourage institutional investors from engaging with directors. However, as the trading ban only applies where inside information is communicated, if the information disclosed during director-shareholder dialogues is not material, institutional investors are free to trade the company's shares. In this respect, the selective disclosure regime provided for under Article 10 of the MAR is, in effect, coextensive with that defined by Regulation FD.

In order to assess the compatibility of board-shareholder engagement with the European market abuse regime, it is also worth noting that Article 11 of the MAR is comprised of specific provisions concerning "market soundings," i.e. interactions between a seller of financial instruments and one or more potential investors prior to the announcement of a transaction in order to gauge the interest of potential investors in a potential transaction and its pricing, size, and structuring. As Recital 32 to the MAR explicitly recognizes, market soundings are a highly valuable tool for enhancing dialogue with shareholders and they measure potential-shareholder interest in participating in a possible transaction (such as an issuance of additional equity).¹³¹

¹³⁰ *Id.*

¹³¹ *Id.* at 7 (Recital No. 32: "Market soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring. Market soundings could involve an initial or secondary offer of relevant securities, and are distinct from ordinary trading. They are a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse."). For an overview of market soundings

As market soundings may entail the disclosure of inside information,¹³² Article 11 of the MAR requires that procedural safeguards be put in place in order to prevent evasion of the market abuse regime. Pursuant to Articles 10(1) and 11(4) of the MAR, market soundings involving inside information should be considered to be compliant with the market abuse regime only if such information is disclosed during the normal course of the exercise of a person's employment, profession, or duties. Disclosure of inside information made in the course of a market sounding will be deemed to be made in such a way only when issuers or other persons disclosing inside information ("disclosing market participants") comply with Articles 11(3) and 11(5) of the MAR.¹³³

practices see Holger Fleischer & Dorothea Bedkowski, *Aktien- und kapitalmarktrechtliche Probleme des Pilot Fishing bei Börsengängen und Kapitalerhöhungen*, 41 DER BETRIEB 2195, 2195–209 (2009).

¹³² See MAR, *supra* note 13, at 29–30 (Article 11(2)-(7) recognizes that market soundings can entail disclosure of material non-public information, as explicitly confirmed also by the Recital 34 to the MAR. "Conducting market soundings may require disclosure to potential investors of inside information. There will generally only be the potential to benefit financially from trading on the basis of inside information passed in a market sounding where there is an existing market in the financial instrument that is the subject of the market sounding or in a related financial instrument. Given the timing of such discussions, it is possible that inside information may be disclosed to the potential investor in the course of the market sounding after a financial instrument has been admitted to trading on a regulated market or has been traded on an MTF or an OTF. Before engaging in a market sounding, the disclosing market participant should assess whether that market sounding will involve the disclosure of inside information."). However, market soundings do not necessarily lead to a disclosure of inside information. See Lombardo & Mucciarelli, *supra* note 126, at 20–21; Bernd Singhof, "Market Sounding" nach der Marktmissbrauchsverordnung, 4 ZEITSCHRIFT FÜR BANKRECHT UND BANKWIRTSCHAFT (ZBB) 193 (2017); Simon Tissen, *Die Investorensuche im Lichte der EU-Marktmissbrauchsverordnung*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 1254, 1259 (2015); Dirk Zetzsche, *Die Marktsondierung gem. Art. 11 Marktmissbrauchsverordnung*, 17 DIE AKTIENGESELLSCHAFT 610, 613 (2016).

¹³³ See MAR, *supra* note 13, at 7 (Recital No. 35: "Inside information should be deemed as being disclosed legitimately if it is disclosed in the normal course of the exercise of a person's employment, profession or duties. Where a market sounding involves the disclosure of inside information, the disclosing market participant will be considered to be acting within the normal course of his employment, profession or duties where, at the time of making the disclosure, he informs and receives the consent of the person to whom the disclosure is made that he may be given inside information; that he will be restricted by the provisions of this Regulation from trading or acting on that information; that reasonable steps must be taken to protect the ongoing confidentiality of the information; and that he must inform the disclosing market participant of the identities of all natural and legal persons to whom the information is disclosed in the course of developing a response to the market sounding. The disclosing market participant should also comply with the obligations, to be set out in detail in regulatory technical standards, regarding the maintenance of records of information disclosed. There should be no presumption that market participants that do not comply with this Regulation when conducting a market sounding have unlawfully disclosed inside information but they should not be able to take advantage of the exemption

Article 11(3) requires that “disclosing market participant[s], prior to conducting a market sounding, specifically consider whether the market sounding will involve disclosure of inside information,” and “make a written record of their conclusions and the reasons therefor.”¹³⁴ Moreover, in order to ensure that market soundings do not violate insider trading rules, Article 11 provides that also “the person receiving the market sounding shall assess for itself whether it is in possession of inside information or when it ceases to be in possession of inside information.”¹³⁵ In order to prevent insider trading rules (especially the associated trading ban) from applying to a person receiving market soundings who is unwilling to receive inside information, the disclosing market participant is requested to obtain prior consent to the disclosure of inside information.¹³⁶ If the person receiving the market sounding consents to receiving material non-public information, insider trading rules will apply to him/her.¹³⁷ Thus, the person receiving market soundings is prohibited from using that information by trading financial instruments to which the inside information relates, and is obliged to keep the information confidential.

Article 11(5) of the MAR further requires disclosing market participants to keep records (and to provide them to the competent authority upon request) of all information given to persons receiving the market sounding, including information given in the context of the market sounding, the identity of the potential investors to whom information has been disclosed, including but not limited to the legal and natural persons acting on behalf of the potential investor, and the date and time of each disclosure.¹³⁸

As has been made clear by the European Supervisory Market Authority (ESMA), the market soundings regime only applies to communications that are intended to assess the interest of potential investors in a possible transaction, and the conditions relating to it, such as its potential size or pricing, but not to investor relations communications generally.¹³⁹ Therefore, the provisions of

given to those who have complied with such provisions.”). *See also* Lombardo & Mucciarelli, *supra* note 126, at 19 (noting that meeting the special procedural conditions set in Article 11 is likely to replace the strict requirements for selective disclosure of inside information set forth by the ECJ in *Grongaard*).

¹³⁴ MAR, *supra* note 13, at 28.

¹³⁵ *Id.* at 29.

¹³⁶ *Id.* at 28.

¹³⁷ *Id.*

¹³⁸ *Id.*

¹³⁹ Discussion Paper, Policy Orientations on Possible Implementing Measures Under the Market Abuse Regulation, European Securities and Markets Authority, ESMA/2013/1649, at para. 62 (Nov. 14, 2013), <https://www.esma.europa.eu/press-news/consultations/esma%E2%80%99s-policy-orientations-possible-implementing-measures-under-market> (“It is important to note that the market soundings regime under

Article 11 of the MAR do not directly apply to the broader area of director-shareholder dialogue concerning governance or strategic issues, on which this article is focused.

Nevertheless, the market soundings regime seems to confirm indirectly that the MAR leaves sufficient scope for director-shareholder dialogue. First of all, Recital 34 and Article 11 of the MAR clearly show that persons involved in market soundings are free to exchange non-material information, and that the procedural safeguards outlined in Article 11 of the MAR are much more significant where inside information is disclosed within market soundings.¹⁴⁰ This is consistent with the general approach of the MAR, according to which the prohibition on insider trading and the public disclosure obligation only apply to inside information, as defined in Article 7 of the MAR. Put differently, Article 11 seems to support that the view that the communication of non-material information is by no means constrained by the MAR.¹⁴¹

Secondly, although the market soundings regime only covers board-shareholder communications that are directed at gauging the interest of potential investors in a possible transaction, the provisions of Article 11 of the MAR are useful in defining a legal framework applicable to director-shareholder dialogue that falls outside the scope of market soundings, on which this article is focused. Specifically, there is a question as to whether, in order to prevent possible breaches of market abuse law, the procedural steps designed by Article 11 of the MAR may give rise to the same protective effects if applied to director-shareholder dialogue concerning governance or strategic issues. Although the MAR does not address this issue at all, it would appear reasonable to answer this question in the affirmative. Indeed, the voluntary application of procedures set out in Article 11 of the MAR, which are aimed at preventing infringements of the market abuse regime, can create a safer context for director-shareholder dialogue and incentivize intuitional investors to engage

MAR is not intended to inhibit relations between the issuer and its investors. The regime only applies to communications intending to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, and not to investor relations communications more generally.”)

¹⁴⁰ See Lombardo & Mucciarelli, *supra* note 126, at 20 (“In this case, the discloser faces simplified duties regarding the minutes and the records that are to be kept. In particular, the discloser should indicate that the recipient is about to receive information that ‘the disclosing market participant considers not to be inside information’ and the recipient should consent to such disclosure on a ‘non-wall-crossed’ basis.”).

¹⁴¹ See Hopt, *supra* note 7, at 7 (noting that only director-shareholder dialogue concerning inside information are prohibited by the MAR).

with issuers.¹⁴² Moreover, in a comparative perspective, it is worth mentioning that such an approach is in line with the notable precedent of the SEC that provides recommendations concerning the adoption of policies and procedures intended to assist in avoiding Regulation FD violations and states that a private communication between an independent director and a shareholder would not present Regulation FD issues if the shareholder provided an express confidentiality agreement.¹⁴³

In conclusion, the public disclosure and insider dealing regime laid forth in the MAR only represents a relative constraint on director-shareholder dialogue, insofar as it prohibits directors from disclosing inside information within private meetings with shareholders, unless shareholders agree to sign a confidentiality agreement and abstain from trading financial instruments to which inside information relates. Although, to the extent that they do give rise to some problematic issues, and can discourage engagement by institutional investors, these constraints should be scaled back. As noted before, investors generally do not intend to receive inside information, since this would restrain their freedom in trading the securities involved. During engagement-related dialogue, institutional investors mainly seek to communicate their opinions and concerns regarding corporate governance matters, business strategies, or individual transactions. Although the MAR requires that safeguards be established in order to prevent inside information from being communicated,¹⁴⁴ and this can increase compliance costs for both the issuers and institutional investors, the European market abuse regime does not genuinely hinder dialogue between directors and key shareholders.

C. Board-shareholder dialogue concerning non-material information does not violate the EU law principle of equal treatment of shareholders

¹⁴² Director-shareholder dialogue concerning governance and strategic issues is clearly beyond the scope of Article 11 of the MAR because, unlike market soundings, it is not intended to gauge interest in a transaction. *See generally* CLEARY GOTTlieb, MARKET ABUSE REGULATION: A BALANCED APPROACH TO THE MARKET SOUNDING REGIME'S APPLICABILITY IN CAPITAL MARKETS TRANSACTIONS (Jun. 26, 2017), <https://www.clearygottlieb.com/~media/cgsh/files/2017/publications/alert-memos/mar--a-balanced-approach-to-the-market-sounding-regimes-applicability-6-27-17.pdf> (“Regular outreach by an issuer to its existing investor base to keep it informed of notable developments (when no transaction is planned) should not constitute a market sounding.”).

¹⁴³ *See supra* text accompanying notes 94-96.

¹⁴⁴ *See infra* Part V.

As mentioned above, one further hurdle that may hinder director-shareholder dialogue within the European context is the principle of equal treatment for shareholders¹⁴⁵ laid down by Article 17 of Directive 2004/109/EC, according to which “the company shall ensure equal treatment for all shareholders who are in the same position.”¹⁴⁶ Similarly, Article 46 of Directive 2012/30/EU provides that “for the purposes of the implementation of this Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position.”¹⁴⁷ Although, with respect to equal treatment, the European Court of Justice has rejected the view that the existence of “certain provisions relating to the protection of minority shareholders is not sufficient in itself to establish the existence of a general principle of Community law, in particular if the scope of those provisions is limited to rights which are well defined and certain,”¹⁴⁸ Article 17 of Directive 2004/109/EC (and the corresponding national implementation rules) is still viewed as a substantial constraint on board-shareholder engagement.¹⁴⁹

Since director-shareholder dialogue may give rise to an informational advantage for the shareholders involved, its compatibility with the equal treatment principle is questionable. In spite of its relevance, the compatibility of director-shareholder dialogue with selective disclosure has not been seriously addressed in the literature, or by the courts.¹⁵⁰

¹⁴⁵ See Hopt, *supra* note 7, at 8–9.

¹⁴⁶ Directive 2004/109 of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC, 2004 O.J. (L 390/38) [hereinafter Directive 2004/109/EC].

¹⁴⁷ Directive 2012/30 of the European Parliament and of the Council of 25 October 2012 on Coordination of Safeguards Which, for the Protection of the Interests of Members and Others, are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 54 of the Treaty on the Functioning of the European Union, in Respect of the Formation of Public Limited Liability Companies and the Maintenance and Alteration of their Capital, with a view to Making Such Safeguards Equivalent, 2012 O.J. (L 315/74).

¹⁴⁸ Case C-108/08, *Audiolux SA v. Grp. Bruxelles Lambert SA (GBL)*, I-09823 (ECLI:EU:C:2009:626). See also Lombardo & Mucciarelli, *supra* note 126, at 35–36; Federico M. Mucciarelli, *Equal Treatment of Shareholders and European Union Law*, 7 EUR. COMPANY & FIN. L. REV. 158, 158–167 (2010).

¹⁴⁹ See Hans C. Hirt et al., *Dialog zwischen dem Aufsichtsrat und Investoren, Rechtsvergleichende und rechtsdogmatische Überlegungen zur Investorenkommunikation in Deutschland*, 20 DIE AKTIENGESELLSCHAFT (AG) 724, 737 (2016); Hopt, *supra* note 7, at 8–9.

¹⁵⁰ See generally Fabrizio Ferraro & Daniel Beunza, *Why Talk? A Process Model of Dialogue in Shareholder Engagement* 3 (Mar. 26, 2014), <https://ssrn.com/abstract=2419571> (“While it is clear that dialogue makes up an inevitable component of any stakeholder engagement, the precise nature and consequences of such dialogue have not been elucidated by existing scholarship.”).

One significant exception concerns a decision by the Danish Supreme Court in the *Vase* case, which involved a merger by acquisition where the directors had established contact with selected shareholders in order to share their views concerning the transaction.¹⁵¹ The compatibility of private dialogue between directors and the relevant shareholders with the principle of equal treatment of shareholders was questioned by a minority shareholder who had bought the company's shares in view of the takeover.¹⁵² Some time later, after it seemed apparent that no takeover would take place, the shareholder decided to sell his shares. However, a few days after he sold his shares, the takeover bid was launched.¹⁵³ The shareholder alleged that if he had been informed about the future offer at the same time as the major shareholders had been, he (as well as other minority shareholders who were not involved in the dialogue that had taken place with key shareholders) would have had the opportunity to take advantage of the positive market price reaction to the takeover announcement.¹⁵⁴

The Danish Supreme Court did not accept the minority shareholder's view. Instead, it stated that directors can lawfully consult with the controlling shareholder and with major shareholders.¹⁵⁵ The case was decided on the basis of two arguments.¹⁵⁶ First, under the corporate governance model characterizing Nordic public companies, the influence of controlling shareholders is considered to be normal and "beneficial" for the company.¹⁵⁷ Dialogue with relevant shareholders is an ordinary and widely accepted practice.¹⁵⁸ Secondly, there had been no breach of the principle of equal treatment of shareholders since this principle applies to shares, and not to shareholders as such. As a shareholder's "weight" within the company depends on the number of shares it holds, not all shareholders are the same.¹⁵⁹

¹⁵¹ See Danish Weekly Law Report, U.f.R. 2006.3359 (2006) (Ugeskrift for Retsvæsen) [hereinafter U.f.R.].

¹⁵² *Id.* at 3359.

¹⁵³ *Id.* at 3360–61.

¹⁵⁴ *Id.* at 3362–63.

¹⁵⁵ *Id.* at 3368–69.

¹⁵⁶ A summary of the arguments made by the Danish Supreme Court's in the *Vase* case is provided by Hansen, *supra* note 25, at 86; see also *id.* at 87 (noting that majority shareholders' influence on the board through dialogue, as well as by sitting in the board, is a commonly accepted feature of the Nordic corporate governance system (so-called active ownership)).

¹⁵⁷ U.f.R., *supra* note 151, at 3368–69.

¹⁵⁸ Hansen, *supra* note 126, at 375 (arguing that the Danish Supreme Court, in its decision in the *Vase* case, held that "selective and confidential disclosure from the board to major shareholders was legitimate under the Danish system of corporate governance").

¹⁵⁹ See NICOLA DE LUCA, EUROPEAN COMPANY LAW 341–42 (2017).

The Danish Supreme Court's opinion is consistent with the wording of Article 17 of Directive 2004/109/EC, which provides that only shareholders "who are in the same position" should be treated in an equal manner.¹⁶⁰ Consequently, it is reasonable to assume that, under European company and financial markets law, major shareholders are not be considered to be in the same position as retail investors with minimal holdings, and the directors should be allowed to engage in dialogue with selected relevant shareholders.

Nonetheless, dialogue between directors and (significant) shareholders is subject to limitations. As has recently been observed by Lombardo and Mucciarelli, directors can never behave arbitrarily vis-à-vis their shareholders, and even if they are allowed to treat some shareholders differently; thus, it is reasonable to expect that the applicable company law regime to require such different treatment to be supported by specific justifications for the benefit of the company as a whole.¹⁶¹

This leads us to a key issue, namely whether private meetings between directors and selected shareholders are supported by specific justifications for the benefit of the company as a whole. This issue has mainly been addressed by German scholars within the intense debate that followed the introduction into the German Corporate Governance Code of a specific recommendation concerning dialogue between members of the supervisory board and shareholders.¹⁶² According to the prevailing opinion, the principle of the equal treatment of shareholders does not preclude dialogue with relevant shareholders, including, specifically, with institutional investors, insofar as there are objective reasons underlying the choice to privately meet shareholders.¹⁶³

Dialogue with relevant shareholders certainly benefits the company as a whole when transactions are initiated that require shareholder approval, as is typically the case for a capital increase.¹⁶⁴ Were the company to announce its intention to raise new capital without previously having gauged the interest of its major shareholders and obtained their informal approval, there would be a risk that the issuer might suffer financial losses in addition to reputational

¹⁶⁰ Directive 2004/109/EC, *supra* note 146, at 31.

¹⁶¹ Lombardo & Mucciarelli, *supra* note 126, at 35. *See also* Hirt et al., *supra* note 149, at 737 (referring to the well-established opinion of the German Supreme Court); Hopt, *supra* note 7, at 8.

¹⁶² *See supra* Part III.B.

¹⁶³ *See* GER. INV. FUNDS ASS'N, *supra* note 75, at 2.

¹⁶⁴ *See* Strampelli, *supra* note 25, at 1043. Among German scholars, *see* Fleischer, *supra* note 16, at 521; Hirt et al., *supra* note 149, at 737; Hopt, *supra* note 7, at 9 ("[D]ialogue by the board with institutional investors outside of the general assembly is justified if the board considers it to be in the interest of the corporation and if no new material inside information is distributed to the public ahead of the ad hoc-disclosure.").

losses. The failure to execute an announced capital increase can negatively impact market prices of the company's shares, which would result in a loss for its shareholders. The issue is clearly addressed by the market sounding regime set out by the MAR. Article 11(2) of the MAR states that "disclosure of inside information[,] by a person intending to make a takeover bid for the securities of a company," or to pursue a "merger with a company[,] to parties entitled to the securities shall also constitute a market sounding, provided that" the "willingness of parties entitled to the securities to offer their securities is reasonably required for the decision to make the takeover bid or merger."¹⁶⁵

The answer to the further question as to whether ongoing dialogue between the directors and the relevant shareholders benefits the company as a whole is less obvious.¹⁶⁶ Still, there are sound reasons for answering in the affirmative. As some scholars have observed, engaging in dialogue with relevant shareholders, especially with institutional investors, is *per se* consistent with the interests of the company, since sound investor relations are crucial for listed companies.¹⁶⁷ Therefore, any deviation from the principle of equal treatment of shareholders for these purposes is not arbitrary, but legitimate. Institutional shareholders and minority retail shareholders cannot be considered to be in the same position, both due to the size of their holdings as well as their attitude towards being active shareholders.¹⁶⁸ Furthermore, the overlap between private dialogues involving directors and relevant shareholders and the issuers' interests is clearly apparent from Directive 2017/828/EU, as well as from the corporate governance codes mentioned above, both of which encourage effective dialogue between directors and shareholders.¹⁶⁹

Moreover, according to the MAR the duty to ensure equal access to information only applies to inside information.¹⁷⁰ Similarly, the disclosure

¹⁶⁵ MAR, *supra* note 13, at 28.

¹⁶⁶ This issue was debated in some jurisdictions before the MAR entered into force, including the possibility of deriving a general principle of the legitimacy of dialogue between the board and (significant) shareholders from the recognized legitimacy of those entered into on specific occasions, in particular in relation to capital increases and mergers. For Germany, see Fleischer, *supra* note 16, 523–25; Hirt et al., *supra* note 149, at 737; Jens Koch, *Investorengespräche des Aufsichtsrats*, 62 DIE AKTIENGESELLSCHAFT (AG) 129, 129–41 (2017). For Belgium, see Koen Geens, *Corporate Boards in Belgium*, in CORPORATE BOARDS IN LAW AND PRACTICE 148 (Paul Davies et al. eds., 2013).

¹⁶⁷ See Hirt et al., *supra* note 149, at 737.

¹⁶⁸ *Id.* at 738.

¹⁶⁹ See *supra* Part II.

¹⁷⁰ Also the ECJ seems to recognize that the duty to ensure equal access to information only applies to inside information. See Case C-45/08, *Spector Photo Grp. NV v. Commissie voor het Bank, Financiering en Assurantiewezen*, ECLI:EU:C:2009:806, ¶ 48 (noting that the purpose of insider trading prohibition "is to ensure equality between the contracting parties

obligation under Article 17 of the MAR only applies to inside information, as defined under Article 7. Therefore, the MAR seems to confirm that a principle of equal information is not absolute in nature.¹⁷¹ Rather, the MAR allows institutional investors to gain an information advantage via dialogue with directors, as long as this does not entail the disclosure of inside information.¹⁷² The same also applies when, if the information received from directors is combined with further pieces of information to form a mosaic, the shareholder concerned may arrive at material information.¹⁷³ Consequently, neither two-way director-shareholder dialogue not involving the disclosure of inside information nor “listen-only” sessions where directors learn about the positions of institutional shareholders violate the equal treatment principle under EU law.

V. DEVELOPING A PRACTICAL FRAMEWORK FOR BOARD-SHAREHOLDER DIALOGUE

As has been shown above, on both sides of the Atlantic there are no absolute legal constraints on director-shareholder engagement. Private meetings between directors and institutional investors fly under the radar of the insider trading and disclosure regime when (as normally occurs) they concern non-material information.¹⁷⁴ Moreover, the risk of disclosing material information is entirely eliminated where issuers only listen to shareholders’ opinions and concerns.¹⁷⁵ In addition, the disclosure of material non-public information within director-shareholder dialogue does not violate the

in stock-market transactions by preventing one of them who possesses inside information and who is, therefore, in an advantageous position vis-à-vis other investors, from profiting from that information, to the detriment of those who are unaware of it.”)

¹⁷¹ Fleischer, *supra* note 16, at 512–13.

¹⁷² Of course, directors can extend face-to-face contacts with major shareholders to other shareholders if this is in the interest of the corporation. *See* Hopt, *supra* note 7, at 10 (noting also that, according to the MAR, “[a]t a minimum all new material facts made available in such a dialogue must be promptly disclosed” and arguing that “[i]t may be advisable to go further and to allow other shareholders direct access to the dialogue, but this goes far and cannot yet be considered to be generally acknowledged good corporate governance.”).

¹⁷³ *See* Fleischer, *supra* note 16, at 512–13; Koch, *supra* note 166, at 137.

¹⁷⁴ *See* the empirical findings collected by Cascino et al., *supra* note 9, at 192 (noting that “management meetings provide information that is useful, but not price sensitive”). *See also* Richard Barker et al., *Can Company-Fund Manager Meetings Convey Informational Benefits? Exploring the Rationalization of Equity Investment Decision Making by UK Fund Managers*, 37 ACCT. ORG. & SOC’Y 207, 214 (2012) (noting that, usually, manager-shareholder dialogue “is about framing and making sense of public domain information, rather than introducing new information”).

¹⁷⁵ *See* DAVIS & ALOGNA, *supra* note 100, at 11.

mandatory disclosure and insider trading regime where recipients agree to sign a confidentiality agreement.

Detecting the transfer of material information raises more substantial problems within two-way private dialogues between directors and shareholders that entail a mutual exchange of information. In these situations, the issuers and institutional investors involved seem to be exposed to significant compliance costs, even if there is a dearth of recent empirical evidence demonstrating the exact level of compliance costs associated with insider trading and public disclosure rules.¹⁷⁶ Moreover, participants in two-way dialogue run the risk of infringing disclosure obligations and insider trading prohibitions, and consequently being fined. In order to reduce these potential drawbacks, issuers and investors are recommended to adopt specific procedures in order to avoid the communication of material non-public information. In this regard, recommendations from corporate governance and stewardship codes, as well as from practitioners, play a major role on both sides of the Atlantic, as they assist in developing a practical framework for safe director-shareholder dialogue and in making dialogue more effective. Against this backdrop, this part focuses on three aspects that are crucial for safe dialogue. These aspects involve identification of the topics to be discussed and the participants to be involved, as well as the issuers' adoption of a policy defining the format and procedure for dialogue.

A. Identifying topics for dialogue

Identifying topics for director-shareholder dialogue is a crucial step in the engagement process. As is clearly recognized under the SDX Protocol, the value of shareholder-director engagement, and decisions as to whether and how to engage, depend on the topics to be discussed.¹⁷⁷ Selecting the issues for discussion is not problematic where the shareholders involved agree to treat the information disclosed as confidential. If this is the case, both Regulation FD and the MAR allow for the selective disclosure of inside information. In

¹⁷⁶ See Richard H. Walzer, Dir., Div. of Enft, U.S. Sec. & Exch. Comm'n, Remarks Before the Rocky Mountain Securities Conference (May 18, 2001), <https://www.sec.gov/news/speech/spch492.htm> (“[A] survey by PricewaterhouseCoopers (PwC) found that 57% of respondents have not incurred any incremental compliance costs in connection with Regulation FD. Of the 43% who have incurred such costs, 90% reported that the costs were moderate or low. In contrast, a study by the Securities Industry Association (SIA) finds that Regulation FD imposes ‘significant costs . . . well in excess of those originally estimated by the SEC.’”).

¹⁷⁷ SDX PROTOCOL, *supra* note 32, at 13.

the most prevalent situation, where institutional investors are not willing to sign confidentiality agreements and the entry into dialogue with investee company directors could constrain their trading activity,¹⁷⁸ it is recommended that issuers only choose issues for which there is a lower risk of disclosure of inside information. Moreover, issuers should adopt specific precautionary measures in order to prevent inside information from being disclosed during private meetings with shareholders.

Specifically, in order to prevent breaches of insider trading rules, participants should make it clear prior to entering into dialogue whether or not they are willing to communicate, or receive, price-sensitive information. The UK Stewardship Code is very explicit in this respect, recommending that institutional investors declare in their stewardship statement if they are willing to receive inside information, to what extent, and recommending that, absent their consent, issuers and their advisors avoid communicating information that, according to the insider trading regime outlined in the MAR, might constrain their ability to trade the issuers' shares.¹⁷⁹

Risks associated with the disclosure of inside information may also be reduced by focusing on the timing of dialogue. For example, the Dutch Corporate Governance Code recommends that meetings with financial analysts—although the same is certainly also the case for dialogue with shareholders—not take place during the period immediately preceding the publication of periodical financial information in order to prevent information concerning the company's economic performance during the relevant reference period from being selectively disclosed.¹⁸⁰ Further precautionary measures that, as recommended by the SEC, may be taken by issuers include the early definition of the issues to be discussed and a check as to their materiality, as well as participation of legal advisors in private meetings with shareholders.¹⁸¹

¹⁷⁸ See Yockey, *supra* note 22, at 213.

¹⁷⁹ UK STEWARDSHIP CODE, *supra* note 4, at 7.

¹⁸⁰ DUTCH CORP. GOVERNANCE CODE MONITORING COMM., DUTCH CORPORATE GOVERNANCE CODE § 4.2.3. (2016), [hereinafter DUTCH CORPORATE GOVERNANCE CODE], <http://www.mccg.nl/?page=4738>. See also Goldstein, *supra* note 9, at 13 (finding that, from the issuers' standpoint, "engagement on governance, environmental and social topics, or on economic transactions, need not to be tied either to quarterly earnings or to the annual meeting, but can logically take place at any point during the year").

¹⁸¹ See *Compliance and Disclosure Interpretations*, *supra* note 41. See also SDX PROTOCOL, *supra* note 32, at 15 ("Companies and investors will prepare for meetings by reviewing relevant materials concerning the institution and individuals with which they will engage (e.g., corporate governance guidelines, proxy voting policy, history of prior engagements with the institution) and the topics to be discussed. Engagement participants will be given appropriate training on legal issues relevant to shareholder-director engagement.").

As far as the issues that should be discussed during dialogue are concerned, it is commonly acknowledged in the U.S. that directors and shareholders should mainly focus on matters of corporate governance. The Commonsense Principles of Corporate Governance recommend that dialogue focus on “governance and key shareholder issues, such as CEO compensation.”¹⁸² Similarly, the ISG stewardship principles recommend that “institutional investors should clearly communicate their views and any concerns with a company’s practices on governance-related matters.”¹⁸³ More detail is provided by the SDX Protocol, according to which topics appropriate for shareholder-director engagement include governance-related issues for which the company board (as opposed to the company management) is directly responsible. By contrast, issues deemed to be inappropriate for shareholder-director engagement include discussion of general business operations, current and projected financial results, strategic execution, and other operational and performance issues for which the company management is directly responsible. Obviously, discussing any material non-public information is also considered inappropriate.¹⁸⁴

A similar view is supported by a majority of company directors, who consider the discussion of governance issues (e.g. executive compensation, board elections) to be appropriate, whilst dialogue with shareholders concerning issues related to the company’s management, such as earnings forecasts, strategic decisions, and risks is viewed as inappropriate.¹⁸⁵

Within the European context, converging recommendations are contained in the corporate governance codes adopted in various member states. The UK Corporate Governance Code recommends that the boards’ chair discusses corporate governance and strategy issues with relevant shareholders.¹⁸⁶ The Belgian Code on Corporate Governance encourages shareholders, especially institutional investors, to assess carefully the corporate governance structure of investee companies.¹⁸⁷ More detailed recommendations can be found in the Guiding Principles for Dialogue between Investors and German Supervisory Boards, according to which topics for dialogue depend on the directors

¹⁸² COMMONSENSE PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 31, at 3.

¹⁸³ *Stewardship Principles*, INVESTOR STEWARDSHIP GROUP, www.isgframework.org/stewardship-principles/ (last visited Jan. 8, 2018).

¹⁸⁴ *See, e.g.*, SDX Protocol, *supra* note 32, at 13 (including, among topics appropriated for shareholder engagement, the executive compensation philosophy and structure and board composition and leadership).

¹⁸⁵ Catherine Bromilow et al., *Director Dialogue with Shareholders*, CORP. BOARD, May–June 2014, at 1, 2.

¹⁸⁶ UK CORPORATE GOVERNANCE CODE, *supra* note 66, at 22.

¹⁸⁷ BELGIAN CODE ON CORPORATE GOVERNANCE, *supra* note 68, at 25.

involved.¹⁸⁸ In relation to members of the supervisory board (whose role is roughly comparable to that of non-executive directors), the Guiding Principles state that they should only engage in dialogue with institutional shareholders concerning matters falling under the supervisory board's responsibilities, leaving all other matters for discussion to the management board in its capacity of the company's legal representative.¹⁸⁹ Thus, the composition of the supervisory board, its appointment process, as well as its remuneration system, can be discussed with institutional investors. More specifically, private meetings with institutional investors may involve the supervisory board's report and relevant matters raised in the corporate governance report, the internal organization of the supervisory board, the design of control and participation processes, committee formation, as well as the supervisory board's efficiency review¹⁹⁰ (while the results of the efficiency review regarding individual members of the supervisory board should not be discussed).¹⁹¹ Moreover, the Guiding Principles state that the remuneration system for the management board, contemplated changes, possible suggestions for improvement, as well as interpretation and, if applicable, the exercise of the discretionary powers of the supervisory board pertaining to remuneration-related matters may also be discussed with investors.¹⁹² In addition, the Guiding Principles admit that the required profile for management board members and the division of duties therein may be discussed in the dialogue.¹⁹³

On the other hand, specific proposals for elections to the supervisory board, or proposals concerning individual candidates should not be discussed. Furthermore, private meetings with institutional shareholders should not involve the development and implementation of corporate strategies, since these are matters falling under the responsibility of the management board. The supervisory board should only explain to shareholders what its role is

¹⁸⁸ GER. INV. FUNDS ASS'N, *supra* note 75, at 3. See also Marcus Lutter, *Stellungnahme zum Vorschlag der Regierungskommission Ziff. 5.2 des Kodex um einen neuen Abs. 2*, DEUTSCHER CORPORATE GOVERNANCE KODEX (2016), <http://www.dcgk.de/en/consultations/commentsreceived.html?file=files/dcgk/usercontent/de/Konsultationen/2016/Stellungnahmen%202016/161213%20Stellungnahme%20Prof.%20Lutter.pdf>.

¹⁸⁹ See Paul L. Davies & Klaus J. Hopt, *Corporate Boards in Europe - Accountability and Convergence*, 61 AM. J. COMP. L. 301, 313 (2013).

¹⁹⁰ The German Corporate Governance Code requires the supervisory board to review the efficiency of its activities on a regular basis. See GERMAN CORPORATE GOVERNANCE CODE, *supra* note 76, at 13.

¹⁹¹ GER. INV. FUNDS ASS'N, *supra* note 75, at 3.

¹⁹² *Id.*

¹⁹³ *Id.*

within the process of strategy definition, and its assessment of its implementation.

Stewardship principles seem to provide less restrictive guidance, since dialogue with shareholders is recommended on any issue of interest for institutional investors. According to the UK Stewardship Code, institutional investors should make the appropriate members of the investee company's board or management aware of concerns that may result in a significant loss in investment value.¹⁹⁴ Likewise, the Italian Stewardship Principles recommend that institutional investors intervene, for example, where they have significant concerns regarding the strategy and performance of investee issuers, their governance structure, or their approach to environmental and social issues.¹⁹⁵

In spite of their wider approach, the provisions of stewardship codes do not appear to result in an increased risk of violating the market abuse regime. In fact, stewardship principles recommend that institutional investors communicate their concerns to investee companies, and thereby only refer to one-way dialogue, during which issuers do not communicate material information.¹⁹⁶

The precautionary measures mentioned above should reduce the risks associated with the disclosure of material non-public information within director-shareholder dialogues. However, topic restrictions and the predetermination of the format of dialogue could chill communication, and convert the shareholder-board relationship into a "lawyer-driven, sterile interaction."¹⁹⁷ Furthermore, in order to serve as effective monitors of directors, institutional investors may find it necessary to exchange information when interacting with directors, as is typically the case when communicating their concerns regarding strategies or specific transactions.¹⁹⁸

Although, as mentioned above, the SEC and the European Parliament recognize in general terms that director-shareholder dialogue does not violate respectively Regulation FD or the MAR, the proposal for introducing a legislative safe harbor by explicitly providing a list of corporate governance topics that are excluded from the scope of application of Regulation FD and

¹⁹⁴ UK STEWARDSHIP CODE, *supra* note 4, at 7.

¹⁹⁵ ITALIAN STEWARDSHIP PRINCIPLES 2016, *supra* note 62, at 16 ("An intervention may be found to be necessary regardless of the investment style and in order to protect the best interests of the collective investment undertakings or portfolios managed.").

¹⁹⁶ *See, e.g., id.* at 17.

¹⁹⁷ *See* Rock, *supra* note 16, at 905.

¹⁹⁸ *See* Yockey, *supra* note 22, at 200–01.

MAR should be supported in principle.¹⁹⁹ However, the introduction of a safe harbor would appear to be far from unproblematic, especially under European law, which embraces the theory of equal access to information, and considering that the European Court of Justice has held that some corporate governance issues (e.g. the intention of a board or supervisory board member to resign before the end of his regular term) can constitute inside information.²⁰⁰

Instead, institutional investors and boards should be provided with more detailed guidance concerning topics, such as corporate governance, that can be discussed within board-shareholder dialogue. Even if such a solution would not establish a proper safe harbor,²⁰¹ it could help reduce (at least in part) compliance costs for both issuers and institutional investors. As a start, such a guidance could be included in corporate governance and stewardship codes, where more detailed recommendations on topics that can be discussed by the boards within private meetings with shareholders could be inserted.²⁰² Should this approach prove not to be effective—due to the non-binding force of corporate governance and stewardship codes—the SEC and European lawmakers (through the European Supervisory Market Authority) might consider providing specific guidance on the topics more suitable to be discussed within board-shareholder meetings.

B. Selecting participants in dialogue (on behalf of the company)

Selecting the directors involved in dialogue with institutional shareholders is another key aspect of the engagement process. The debate currently focuses on the involvement of non-executive directors in dialogue with relevant

¹⁹⁹ See Rock, *supra* note 16, at 905 (“For example, creating a safe harbor from Regulation FD for a defined set of ‘high level’ topics would facilitate productive communication. The model should be the sort of relationship that exists between private equity funds or venture capitalists and the managers in a private company, with the exclusion of price-sensitive information like earnings.”). See also DAVIS & ALOGNA, *supra* note 100, at 5; Yockey, *supra* note 22, at 211–14.

²⁰⁰ Case C-19/11, Markus Geltl v. Daimler AG, 2012 ECLI:EU:C:2012:397. See generally Alexander Hellgardt, *The Notion of Inside Information in the Market Abuse Directive: Geltl*, 50 COM. MAR. L. REV. 861 (2013).

²⁰¹ See Yockey, *supra* note 22, at 213 (“Of course, any guidance that is not sufficiently tailored to the issues that arise during private negotiations runs the risk of presenting the same predictive difficulties faced by firms trying to determine Regulation FD’s application *ex ante*.”).

²⁰² The Guiding Principles for Dialogue between Investors and German Supervisory Boards seem to be a notable precedent since they provide a quite detailed list of topics that supervisory board members can discuss with institutional investors. See GER. INV. FUNDS ASS’N, *supra* note 75, at 3.

shareholders, as it has been acknowledged that executive directors and managers play the role of leading shareholder engagement with respect to operating performance, financial matters, strategic execution, and other operational and performance matters for which they are directly responsible.²⁰³ Due to their monitoring role within the board, non-executive directors are the preferred point of contact for institutional investors performing their stewardship function. Although differences between the United States and the European Union regarding the role of the board are more ostensive than real,²⁰⁴ debates concerning the selection of participants in dialogue on behalf of the company seem to be more advanced in Europe, although U.S. corporate governance best practices also provide some general recommendations.²⁰⁵ For this reason, principles from corporate governance codes adopted in EU Member States may offer some useful insights for U.S. issuers and practitioners as well.

First, European corporate governance codes stress that the chairperson of the board should play a central role in board's engagement with shareholders.²⁰⁶ The UK Corporate Governance Code recommends that the chair discuss governance and strategy with major shareholders, and ensure that all directors are made aware of their major shareholders' issues and concerns.²⁰⁷ Along the same lines, Danish Recommendations on Corporate Governance state that "on behalf of the board of directors, the chairman should ensure good and constructive relations with the shareholders."²⁰⁸ According to the German Guiding Principles for dialogue between investors and German supervisory boards, the board's chair represents the supervisory board in communications with investors and informs the entire supervisory board members about the

²⁰³ SDX PROTOCOL, *supra* note 32, at 11–12.

²⁰⁴ See, e.g., JOHN ARMOUR ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 50–51 (3d ed. 2017).

²⁰⁵ See, e.g., COMMONSENSE PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 31, at 3 (recommending that "certain directors" involved in dialogue with shareholders should be experienced in such matters). Similarly, see *Corporate Governance Principles for US Listed Companies*, Investment Stewardship Group, <https://www.isgframework.org/corporate-governance-principles/> (last visited Jan. 8, 2018) (laconically recognizing that "[t]he appropriate independent directors should be available to engage in dialogue with shareholders").

²⁰⁶ Similarly for the United States, see BUSINESS ROUNDTABLE, *supra* note 48, at 26 ("Direct communication between directors and shareholders should be coordinated through — and with the knowledge of — the board chair, the lead independent director, and/or the nominating/corporate governance committee or its chair.").

²⁰⁷ UK CORPORATE GOVERNANCE CODE, *supra* note 66, at 8.

²⁰⁸ DANISH RECOMMENDATIONS ON CORPORATE GOVERNANCE, *supra* note 70, at para 1.1.1.

dialogue.²⁰⁹ The chair is also entitled to decide whether to engage in specific dialogue.²¹⁰ The central role played by the board's chair is underscored also by the provisions of paragraph 5.2. of the German Corporate Governance Code, which states that the chairperson of the supervisory board should be available—within reasonable limits—to discuss supervisory board-related issues with investors.²¹¹

Furthermore, it is a mainstream view within Europe that director-shareholder dialogue should also involve non-executive directors other than the board chair. Specifically, the lead independent director and the chairpersons of the board's committees should be involved where the board deems it appropriate, or if requested by the shareholders. The UK Corporate Governance Code assigns non-executive directors an especially relevant role, stating that they should be offered the opportunity to attend scheduled meetings with major shareholders, and expected to attend meetings if requested to do so by major shareholders.²¹² The senior independent director should attend meetings with a range of major shareholders to listen to their views, in order to help develop a balanced understanding of their views and concerns.²¹³ Also, the senior independent director should be available to address shareholder concerns that dialogue through the normal channels of the chairman, the chief executive, or other executive directors, has failed to resolve, or for which such contact is inappropriate.²¹⁴ In order to encourage non-executive directors to take an active role, the UK Corporate Governance Code requires the board to disclose in its annual report the steps taken to ensure that board members, especially non-executive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings, and surveys of shareholder opinion.²¹⁵

Selecting participants in dialogue on behalf of the company is more complex in Italy, where the Consolidated Act on Finance (*Testo Unico della Finanza*) requires that at least one member of the board be elected by minority shareholders by means of the so-called slate system for electing directors.²¹⁶

²⁰⁹ GER. INV. FUNDS ASS'N, *supra* note 75, at 4.

²¹⁰ *Id.*

²¹¹ GERMAN CORPORATE GOVERNANCE CODE, *supra* note 76, at 9

²¹² UK CORPORATE GOVERNANCE CODE, *supra* note 66, at 22.

²¹³ *Id.*

²¹⁴ *Id.* at 9.

²¹⁵ *Id.*, at 22.

²¹⁶ Decreto Legislativo 24 febbraio 1998, n.58, art. 147-ter (3) (It.) (Consolidated Law on Finance) (“[A]t least one member shall be elected from the minority slate that obtained the largest number of votes and is not linked in any way, even indirectly, with the shareholders

Therefore, with respect to the boards of Italian listed companies, a distinction is necessary between (i) the executive and non-executive-independent directors and (ii) the directors elected by the majority or the minority. This peculiar feature of the current Italian regulations of corporate governance raises the question as to whether directors drawn from the minority slate are allowed to make contact directly with the minority shareholders that elected them. Since minority slates are usually supported by institutional investors, the establishment of a direct channel of communication with minority-elected directors would grant institutional investors direct and permanent access to the board. Guidance concerning the role of directors elected by the minority is provided by the Italian Stewardship Principles, which were significantly overhauled in 2016.²¹⁷

Under the previous version of the Principle No. 3, any institutional investors that had significant concerns regarding the strategy and performance of investee listed issuers were encouraged to intervene by requesting a meeting with the management and/or the auditors (the chairperson of the administrative body, executive directors, the lead independent director, the chairperson of the auditing body or independent directors elected by investment management companies and institutional investors, where present).²¹⁸ More specifically, according to the Principles as previously applicable, discussion with independent minority board members was viewed as a permissible means of intervention and active communication for institutional investors, provided that: it was carried out within an organized and collective procedure; it occurred upon request by minority members of the board, or on the initiative of institutional investors, provided in the latter case

who presented or voted the list which resulted first by the number of votes. In companies organized under the one-tier system, the member elected from the minority slate must satisfy the integrity, experience and independence requirements established pursuant to Articles 148(3) and 148(4). Failure to satisfy the requirements shall result in disqualification from the position.”). *See generally* Guido Ferrarini et al., *Corporate Boards in Italy, in CORPORATE BOARDS IN LAW AND PRACTICE* 367, 392–93 (Paul Davies et al. eds., 2013); Matteo De Poli & Pierre de Gioia Carabellese, *The Minority Directors in the Corporate Governance of EU Listed Institutions: A Chimera or a Possibility?*, 24 *MAASTRICHT J. EUR. & COMP. L.* 43, 48–57 (2017).

²¹⁷ *See* ASSOGESTIONI, *MONITORAGGIO SULLO STATO DI APPLICAZIONE DEI PRINCIPI ITALIANI DI STEWARDSHIP PER L’ESERCIZIO DEI DIRITTI AMMINISTRATIVI E DI VOTO NELLE SOCIETÀ QUOTATE* - REPORT 2016 3 (2016), <http://www.assogestioni.it/index.cfm/1,815,0,49,html/principi-italiani-di-stewardship>.

²¹⁸ *See* ASSOGESTIONI, *ITALIAN STEWARDSHIP PRINCIPLES 17* (2015) [hereinafter *ITALIAN STEWARDSHIP PRINCIPLES* 2015], http://www.assogestioni.it/index.cfm/8,815,0,59/principi-it-stewardship_settembre2015.pdf.

that a meeting had previously been held with the chairperson, executive directors, or the lead independent director of the investee issuer.²¹⁹

The previous version of the Principle No. 3 raised concerns among issuers, who considered that they were not fully in line with international practice.²²⁰ In fact, the Italian Stewardship Principles allowed, without considering the allocation of functions within corporate bodies, minority members of the board to engage in dialogue directly with the institutional investors who had elected them without requiring the participation of other board members, the auditing body, or other managers.²²¹

Following these criticisms, the Italian Stewardship Principle No. 3 was revised in 2016. At present, the revised version of Principle No. 3 recommends that institutional investors meet with the chairman of the board, the executive directors, the lead independent director, the chairperson of the auditing body, the chairperson of an internal committee or other independent directors, including minority members, taking into account the allocation of functions within corporate bodies.²²² Furthermore, the Principle makes it clear that dialogue between directors and institutional investors should be conducted according to an organized and collective procedure which, among other things, ensures the compliance with the general principle of absence of mandate limits with the shareholders who submitted or voted the candidacy.²²³

The revised version of Stewardship Principle No. 3 seems appropriate to favor more effective dialogue between the board and institutional investors. The selection of the board's minority members involved in dialogue is no longer dependent only on the nominating shareholders but also on the role played by a given director within the board (e.g. the lead independent director or the chair of a board's committee), in line with international best practice.²²⁴ Thus, as far as the role of the board's member appointed by the minority shareholders is concerned, the Italian experience offers an insight that may be

²¹⁹ *Id.*

²²⁰ See Gabriele Galateri, *Lavorare nell'interesse di tutti gli azionisti*, IL SOLE24ORE (Mar. 30, 2016), <http://www.intermediachannel.it/lavorare-nellinteresse-di-tutti-gli-azionisti/>. But see Luigi Zingales, *I consiglieri di maggioranza e il loro ruolo nel board*, IL SOLE24ORE (Mar. 27, 2016), <http://www.ilsole24ore.com/art/commenti-e-idee/2016-03-27/i-consiglieri-maggioranza-e-loro-ruolo-board-081206.shtml?uuiid=ACDwMYvC>.

²²¹ ITALIAN STEWARDSHIP PRINCIPLES 2015, *supra* note 218, at 17.

²²² ITALIAN STEWARDSHIP PRINCIPLES 2016, *supra* note 62, at 17.

²²³ *Id.*

²²⁴ For example, similar recommendations provided by the SDX PROTOCOL, *supra* note 32, at 14 (“The company will specify participating directors based on the specific topic(s) to be discussed. Participants will be chosen based on experience, expertise, board role, and past relationship with the investor. The independent non-executive chairman, lead director, or relevant board committee chair will be one of the attendees.”).

repeated in other jurisdictions, such as the U.S., which allow minority shareholders to elect board members.²²⁵

In conclusion, with regard to two-way dialogue entailing mutual exchange of information between directors and shareholders, two final points must be made regarding the selection of board members involved in dialogue with institutional shareholders. First, director-institutional shareholder dialogue should avoid information asymmetries within the board. It is therefore crucial that all board members be informed within a reasonable amount of time concerning any dialogue with institutional investors.²²⁶ The board chair should play a key role in this process. The possibility for an individual board member to engage in direct dialogue with the shareholders who proposed or approved his/her election can impede the board's cohesiveness and undermine trust among directors. Quite obviously, risks for board cohesiveness are much less relevant within one-way dialogue with a limited number of shareholders willing to communicate their concerns and opinions to directors, without receiving, in turn, any information from directors. However, also in this case, in order to prevent information asymmetries within the board, directors contacted by shareholders have the duty to share the information received with the full board.²²⁷

Second, whilst a flexible approach allowing for case-by-case decisions as to which non-executive directors should be involved in a given conversation based on the issues to be discussed is theoretically preferable, an individual board member should only ever privately meet with institutional shareholders in exceptional cases,²²⁸ unless institutional shareholders asking for a dialogue

²²⁵ For an overview of national rules allowing minority shareholders to appoint their representatives to the board *see, e.g.*, ARMOUR ET AL., *supra* note 204, at 53–55.

²²⁶ It is questionable whether dialogue with shareholders needs a prior agreement of the whole board. *See* Hopt, *supra* note 7, at 12 (“[T]he chairman will be well advised to secure an informal general agreement of the board for having such dialogues with investors. On the other hand, having to seek agreement for each individual dialogue and even having to obtain a formal board resolution for this would be too much and cannot be seen as being required by the law. In any case, if the board does not oppose the dialogue, it is up to the chairman of the board to have the dialogue with the investors since the chairman represents the board in the public.”).

²²⁷ *See* ITALIAN STEWARDSHIP PRINCIPLES 2016, *supra* note 62, at 17 (stating that dialogue with shareholders should be carried out within an organized and collective procedure that, among other things, expressly requires the commitment of involved board members “not to disclose sensitive or confidential information when in those occasions”, and “foresees a prompt informative notice to the investee company’s boards about the content and the methods of the meetings”).

²²⁸ *See* Bromilow et al., *supra* note 185, at 3 (“With rare exception, a director should never meet alone with a shareholder. Someone else, most commonly inside or outside counsel, should attend.”). *See also* SDX PROTOCOL, *supra* note 32, at 14 (“Participating institutions often

with directors are clearly willing only to communicate their opinions and concerns, without, in turn, receiving information from board members.²²⁹ Where the chairperson of the board and the lead independent director cannot take part in a meeting with institutional investors, or where it is appropriate that they not be involved, or where institutional investors request dialogue with other non-executive independent directors, the non-executive board member selected should meet the shareholders along with a company manager, usually the person responsible for investor relations. This is useful in order to avoid director-shareholder dialogue giving rise to information asymmetries within the board, and to restrict the risk of violating insider trading and market abuse rules.

C. Adopting and disclosing a policy on director-shareholder meetings

The format and subject matter of dialogue with shareholders should ideally be decided on a case-by-case by the directors, based on a variety of factors including, for example, the appropriateness of the proposed topic, the specific investors asking for the meeting, and the approach of specific investors to investment and corporate governance.²³⁰ However, issuers should adopt a policy on director-shareholder communication that regulates the same issues on a pre-determined basis. For example, as regarding the process by which shareholders can request direct dialogue with the board, policies could define which directors must be involved in dialogue, and which topics can be discussed.²³¹ In addition, many corporate governance experts recommend the adoption of a policy on director-shareholder dialogue, as this helps to increase shareholder awareness as to how the company enters into dialogue and its expectations.²³²

Nevertheless, it would be useful if Corporate Governance Codes recommended the adoption and disclosure of a policy on director-shareholder dialogue. In this respect, the Dutch regulatory approach is illustrative. Article 4.2.2 of the Dutch Corporate Governance Code recommends that “the company should formulate an outline policy on bilateral contacts with the shareholders and should post this policy on its website.”²³³ Pursuant to a

select two or more individuals to represent them in engagements in order to ensure regulatory compliance, mitigate risks of misunderstanding, and improve communication after the engagement.”).

²²⁹ See *supra* text accompanying note 227.

²³⁰ SDX PROTOCOL, *supra* note 32, at 12.

²³¹ *Id.*

²³² Bromilow et al., *supra* note 185, at 3.

²³³ DUTCH CORPORATE GOVERNANCE CODE, *supra* note 180, at 37.

comply-or-explain provision, the company must provide a substantive and transparent explanation when it does not adopt such a policy. The Dutch Code does not regulate the contents of the policy, but in most cases practice shows that the policy applies to both procedural aspects and the format of dialogue. For example, the policy on bilateral contacts with the shareholders adopted by Ferrari N.V. (the world-famous Italian carmaker whose seat is located in the Netherlands) states that:

Ferrari's policy is to provide all shareholders and other parties in the financial markets with equal and simultaneous information about matters that may influence the share price. Ferrari will take into consideration all requests from shareholders to enter into a conversation. Ferrari will agree to such requests for those situations where Ferrari's board of directors deems this in Ferrari's interest. The initiative to enter into a conversation with a shareholder can also be taken by Ferrari.

In order to assess whether a conversation with shareholders could be in Ferrari's interest, Ferrari may request shareholders to provide certain (written) information. This information can include the goal of the conversation, the matters to be discussed, the opinion of the shareholders on these matters and information in respect of the shareholder and its interest in Ferrari.

[. . .]

Ferrari's policy is that, where possible, at each conversation with shareholders at least two Ferrari representatives should be present.²³⁴

In order to favor effective dialogue with institutional shareholders, corporate governance experts further recommend that issuers disclose their engagement activities, including specifying which directors were involved, what topics were discussed, and what action the board has taken in response to institutional shareholders' concerns.²³⁵ One recommendation of this kind can

²³⁴ See FERRARI N.V., POLICY ON BILATERAL CONTACTS WITH THE SHAREHOLDERS (Jan. 3, 2016), http://corporate.ferrari.com/sites/ferrari15ipo/files/5_ferrari_n_v_bilateral_contact_policy_1.pdf.

²³⁵ See PRICEWATERHOUSECOOPERS, DIRECTOR-SHAREHOLDER ENGAGEMENT: THE NEW IMPERATIVES 7 (2016), <https://www.pwc.com/us/en/governance-insights-center/publications/pwc-director-shareholder-engagement-the-new-imperatives.html>.

be found in Article 8.4. of the Belgian Code on Corporate Governance, according to which an issuer should disclose on its website “direct and indirect relationships between the company and major shareholders.”²³⁶ In the U.S., a large number of listed companies disclose such information. The PWC analysis of 2016 proxy statements shows that 64% of the 100 S&P 500 companies included in the sample disclosed information concerning their engagement with shareholders.²³⁷

As has been suggested by one scholar, issuers could report on which shareholders, and with what frequency, they entered into dialogue, and disclose a very short description of the contents of discussions, considering that a wider disclosure could result in an excessive administrative burden and discourage activist shareholders.²³⁸ Specifically, Bengtzen’s proposal that the board should, on a quarterly or semi-annually basis, disclose certain standard details concerning any meetings conducted, such as the identities of counterparties, dates, and start and end times, along with brief descriptions of the corporate purpose of each meeting, should be supported.²³⁹ Following the example of the market soundings regime outlined by Article 11 of the MAR, issuers could also be required to keep records of their meetings with shareholders.

Disclosing information concerning board-shareholder dialogue would benefit all shareholders (including retail shareholders),²⁴⁰ since it would promote an awareness of the identity of shareholders that have entered into dialogue with the issuer and facilitate enforcement of both Regulation FD and Market Abuse Regulation.²⁴¹

VI. CONCLUSION

Within a corporate governance landscape characterized by the growing importance of institutional shareholder engagement, board-shareholder

²³⁶ BELGIAN CODE ON CORPORATE GOVERNANCE, *supra* note 68, at 24.

²³⁷ *Id.* at 2.

²³⁸ *See* Bengtzen, *supra* note 104, at 122–26.

²³⁹ *Id.* at 125 (“From the perspective of the recipients, the publicity of the fact that they have met management should be a small price to pay for an information advantage provided by the firm and indirectly paid for by its shareholders as a group.”). *See also* Solomon & Soltes, *supra* note 9, at 353–54 (“One possible solution is to publicly publish a transcript of these private interactions as firms currently provide for quarterly earnings conference calls with analysts.”).

²⁴⁰ Solomon & Soltes, *supra* note 9, at 353–54 (“Such a practice would continue to facilitate private meetings but also allow all market participants access to the information being disclosed regardless of their ability to gain private access.”).

²⁴¹ Bengtzen, *supra* note 104, at 128–29.

dialogue is becoming an increasingly common practice both in the U.S. and in Europe. Board-shareholder dialogue is essential in order to enable institutional investors to fulfill their stewardship functions. Board-shareholder engagement is also central to listed companies' communication strategies, since the growing demand for engagement by institutional investors has rendered traditional investor relations insufficient.

Nevertheless, director-shareholder dialogue occurs within an area of tension between corporate governance trends and financial markets law. Private meetings between directors and institutional investors raise concerns with respect to the financial markets law framework both in the United States and the European Union, as they may lead to the disclosure of material non-public information to selected shareholders. In the U.S., disclosure of material non-public information is hindered by the selective disclosure regime set out in Regulation FD, and can lead to infringements of the rules on insider trading. Similarly, the European market abuse regime seems to hinder dialogue between directors and key shareholders as it requires the disclosure of inside information, and prohibits anyone receiving inside information from trading in the issuers' securities.

However, legal constraints deriving from U.S. and EU financial markets law should not be overstated, as they do not definitively prohibit board-shareholder dialogue. First, insider trading and disclosure rules only apply to the communication of material non-public information. Therefore, as has been recognized by the SEC and by European lawmakers, they do not hamper dialogue as long as discussions do not involve inside information. Furthermore, when fulfilling their stewardship functions, institutional investors are primarily interested in communicating their views or concerns to investee companies, and do not want to receive material non-public information so that they may continue to freely trade securities issued by said investee companies.

Recommendations from corporate governance and stewardship codes, as well as good practice standards drafted by corporate governance experts and institutions, outline a practical framework that reduces the risk of violating disclosure rules and favors board-shareholder engagement. To further promote these engagements, corporate governance and stewardship codes should provide more detailed guidance concerning board-shareholder dialogue, by indicating, for example, topics more suitable to be discussed or procedures to be implemented in order to avoid information leaks.

However, the provisions of codes and statements of best practice are not binding, as issuers and institutional investors are free to decide not to adopt them, and stipulate only a limited safe harbor. Hence, should the corporate governance and stewardship code-based approach prove not to be effective,

incentives for directors and institutional investors to engage could be enhanced by the SEC and the European Parliament. Those institutions might provide directors and investors with more detailed guidance concerning the topics that can be discussed within board-shareholder dialogue and the precautionary measures that could be adopted.

Whilst either solution would not establish a safe harbor, and judges and supervisory authorities might still take action against issuers and institutional investors based on alleged breaches of the disclosure and insider trading legal framework, it could help to promote board-shareholder engagement by limiting compliance costs for both issuers and institutional investors.