

QUESTIONING THE DUTY OF LOYALTY

FROM TIME TO TIME, corporate governance looks more like the Wild West than the staid corporate boardroom, drawing attention not only to board member conflicts of interest but also to who actually controls the election of directors.

Such was the case at Facebook this month after board member and PayPal co-founder Peter Thiel disclosed he secretly provided \$10 million to pay the legal fees of wrestler Hulk Hogan in Hogan's invasion-of-privacy lawsuit against Gawker Media. The \$140 million ruling in Hogan's favor led Gawker to file for bankruptcy.

The revelation of Thiel's involvement immediately brought calls for his removal from the Facebook board, with many charging his actions were a conflict of interest given the firm's business relationship with Gawker and Facebook's growing role as a portal to digital news. It also raised questions about the role of third-party big money in the court system.

Nevertheless, Thiel retained his board seat at Facebook's annual meeting, with the support of Facebook founder Mark Zuckerberg and his fellow Facebook directors. From the start, it was apparent that it would be difficult to show that Thiel's support of Hogan's lawsuit against Gawker violated his key fiduciary duties as a director—the duty of care and the duty of loyalty. These two fundamental duties require a corporate director to act in good faith for the benefit of the company, to disclose potential conflicts of interest early on, and to refrain from self-dealing while making decisions on behalf of the company.

Most board conflict-of-interest cases focus on directors whose actions seek personal financial gain. Yet Thiel's financial support for the Hulk Hogan suit came from his charitable foundation, and Thiel did not seek, nor did he receive, any monetary reward. News reports have called Thiel's funding an act of revenge for Gawker's 2007 story outing him as gay. Others say it was because Gawker targeted Thiel's business dealings. But Thiel himself has said his support was meant to be a deterrent to the kind of journalism that victimizes and bullies people when there's no connection to the public interest.

Given that Facebook had contractual relationships with Gawker at the time, did Thiel's actions violate his duty of loyalty? In a strict legalistic sense, the answer is no, as Thiel did not seek, and did not receive, monetary gain from his involvement in the Gawker suit. In addition, the loss of Gawker revenue apparently inflicted no material economic harm to Facebook. Still, the episode puts the spotlight on the duty of loyalty and how broadly it can be viewed.

A key role of a director is to raise questions and to occasionally play the devil's advocate in the decision-making process. A board of directors should not be a consensus group, blindly deferring to the will of management. It seems antithetical to argue that a board member should be restricted from actions such as taking a public policy position, representing a

charity, or supporting a political candidate who might be offensive to some. Thiel, for example, is a supporter of Donald Trump and will be a Trump delegate at the upcoming Republican convention.

The Thiel case also highlights the unusual governance structure of Facebook, a structure found in a handful of high-tech companies with "guru" founders. While Mark Zuckerberg owns 28.2% of Facebook shares, he controls a majority of all voting shares, thanks to voting rights designed to preserve Zuckerberg's control when Facebook went public. That means he has full control of who sits on Facebook's board of directors. So at this month's annual meeting, Zuckerberg saw to it that Thiel was reelected to the board.

The incident is a cautionary tale to both companies and their boards of directors. How far does the duty of loyalty extend? Must a director refrain from taking public positions that do not square with the economic interest of the company on whose board the director sits? Shareholder patience and public opinion may be sorely tried if such behavior becomes a common occurrence. ■■■■

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