

WHY CAN'T WE BE FRIENDS?

DIRECTOR PENALIZED BY SEC FOR FAILING TO DISCLOSE CLOSE RELATIONSHIP WITH COMPANY EXECUTIVE

Oct 07, 2024

WHAT HAPPENED

Recently, the SEC announced [settled charges](#) against a former chairman/CEO and director of Church & Dwight Co. Inc., for violating proxy disclosure rules by standing for election as an independent director without informing the board of his close personal friendship with an executive officer.

Without admitting or denying the allegations, James Craigie agreed to a civil penalty of \$175,000 and a five-year officer-and-director bar, and to be permanently enjoined from further violations. The settlement is subject to court approval.

TAKEAWAYS

Stock exchange rules generally require boards to affirmatively determine each director's independence. SEC rules require companies to identify in proxy statements each director deemed independent, reference the relevant independence standards, and describe, by category or type, those matters considered in determining independence.

To gather the needed information for determinations of director independence and other required disclosures, companies have long followed the practice of circulating D&O questionnaires to directors and officers. Law departments typically review these D&O questionnaires, filter out immaterial information, and consolidate the results in a memo or presentation for consideration by the board of directors.

Avoid over-reliance on D&O questionnaires

The case against Craigie illustrates the perils of relying solely on responses to questionnaires and the value of engaging in discussion or follow-up to make sure directors consider the breadth of the questions. Here, for example:

- The company's D&O questionnaire asked whether directors had any material relationship with the company, listing as examples commercial, industrial, banking, consulting, charitable, and familial relationships. Although indicating the list was non-exhaustive, the questionnaires did not expressly address friendships with executives.
- The SEC charged that Craigie consciously hid the relationship from the board. The [SEC Complaint](#) noted that Craigie had expressed concern that disclosure of the friendship with the Executive "would make me appear biased toward [the Executive] as the next CEO."
 - It isn't entirely clear that, when Craigie withheld that information on the several occasions detailed by the SEC in its complaint, he recognized the potential implications of his friendship to the board's determination of his independence.
 - At one point, the complaint noted: "Craigie, among other Board members, voiced concern about the internal candidates, including Executive," and Craigie proposed an outside candidate for the job instead. On the other hand, the SEC indicated Craigie thought the Executive could be positioned as a potential future successor.
 - A reference to personal relationships in the questionnaire, or further discussion with Craigie, might have led to fuller appreciation of the breadth of the question regarding material relationships and thus disclosure of the friendship.

Other action items for public companies

Public companies also should consider:

- **Reviewing corporate governance documents**, such as guidelines and board committee charters and the framing of requirements for independence.
- **Educating directors** about the importance of completing their questionnaires accurately and completely and the potential liability of the company and directors individually for disclosure failures.
- **Evaluating controls and procedures** for determining independence, including whether questionnaires as drafted sufficiently elicit potentially relevant information beyond the examples listed in stock exchange rules.
- **Recognize the greater breadth of state corporate laws**, which may impose more rigorous or nuanced requirements for a director to qualify as independent than stock exchange rules. For example, Delaware courts consider compensatory, financial, and business relationships, as well as social and personal ties, in their totality. Accordingly, companies should not rely solely

on compliance with stock exchange independence standards to determine director eligibility to serve on a board committee evaluating conflict of interest transactions.

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According to the [SEC Complaint](#):

Background

James R. Craigie was appointed as Church & Dwight's CEO in 2004 and held that role for over eleven years. He served on the board as non-executive chairman from 2007 to 2019 and as a non-independent director from 2004 to 2019. He became an independent director in 2019.

Based on his D&O questionnaires, the board determined Craigie was independent in January 2019 and 2020, and the shareholders elected him as an independent director at the 2020 annual meeting.

From 2020 through 2023, he failed to disclose that he maintained a close personal friendship with another executive ("Executive").

Craigie and Executive maintained close personal friendship

Around 2017, Craigie began to mentor Executive consistent with his practice with promising employees. Shortly thereafter, Craigie formed a personal friendship with Executive. Over the next few years, Craigie and his spouse vacationed internationally with Executive and his spouse six times, traveling to eight countries on five continents. Craigie invited several other couples on these trips and generally paid for all guests' business class airfare and luxury lodging. In total, Craigie paid more than \$100,000 for Executive and his spouse to travel on these vacations.

Craigie and Executive, along with their spouses, also vacationed together domestically over long weekends, and Executive occasionally stayed at Craigie's apartment in Miami. Craigie took Executive and his family on boat trips in New York, Connecticut, and Miami.

Craigie did not similarly vacation with, nor pay expenses for, other executives.

Craigie hid the friendship from the company

Craigie withheld, and instructed Executive to withhold, the nature of their relationship from the company. For example:

- Before their first international trip in January 2020 and thereafter, Craigie asked Executive not to mention their upcoming vacation to anyone at the company.
- When Executive received a promotion in January 2021 and had the opportunity to make a presentation to the board, Craigie offered to help but said "do not mention me at all as it would make me appear biased toward you as the next CEO."

- In July 2021, Craigie told another board member that he would be “at a friend’s birthday bash” in a foreign country but did not identify the “friend” as Executive, although the other board member knew Executive.
- In January 2023, while traveling together overseas shortly before a board meeting, Craigie asked Executive what he was telling other executives about his trip so that Craigie would not reveal that he was in the same place. When Executive explained that he had said he was travelling to a different location than where they were going, Craigie approved.

Board affirmatively determined independence without knowledge of the friendship

The board made its determinations of independence based on D&O questionnaires. The questionnaires stated that for a director to be independent, the board must affirmatively determine that the director has no “material relationship” with the company. They included as examples of such relationships commercial, industrial, banking, consulting, charitable and familial relationships. After describing the list as non-exhaustive, the questionnaires asked if directors have “any other relationship” with the company or its management. Craigie answered “no.”

SEC charged Craigie knew or should have known that his friendship was relevant

The SEC contended that Craigie, as an experienced public company executive and board member, knew or should have known the relevance of his friendship to the board’s evaluation of his independence. For example, Craigie was an independent board member at two other public companies where he completed questionnaires that contained similar questions.

The SEC suggested that those questionnaires revealed what facts and circumstances he should have considered when responding to the company’s questionnaire. The complaint notes that he was often more descriptive than in the Church & Dwight questionnaire and disclosed information that was informative, but not necessarily responsive, to questions. For example, for one company, Craigie disclosed that another company donated to a charity that he was involved with even though the question only asked about donations made by the first company.

Craigie’s participated in CEO search without disclosing relationship

In early 2022, the CEO informed the board that he was considering retiring no earlier than the end of 2023. The board began evaluating internal candidates, including Executive, to replace the CEO after retirement. Craigie participated in the CEO succession process that included Executive despite his undisclosed close personal relationship with Executive.

At a board meeting in August 2022, Craigie, among other board members, voiced concern about the internal candidates, including Executive.

Around this time, Craigie disclosed the CEO succession process to Executive. Craigie said he did this to persuade Executive not to resign after he confided that he was thinking of resigning. However,

board members had been instructed to keep the search confidential and Craigie did not disclose to the board that he told Executive about the succession process.

The board ultimately decided to retain an outside search firm. Once retained, the search firm asked directors to propose external candidates. Craigie suggested a qualified external candidate who was a former colleague of Executive's from a different company. Craigie did not disclose that this candidate was a former supervisor of Executive or that he had attended an international birthday vacation celebration for Executive with this candidate. Craigie and Executive separately discussed that if this candidate was hired, it could provide a viable path for Executive to succeed them.

The individual ultimately became a strong candidate for the CEO role before the board became aware of Craigie and Executive's friendship.

Upon learning about the friendship, the board halted the CEO search and formed a special committee

In February 2023, the board became aware of the friendship and formed a special committee to investigate Craigie's conduct. The CEO postponed his retirement indefinitely and the board halted the CEO succession process to allow time to reconsider how to structure the process in a way to eliminate bias.

The special committee found that Craigie failed to disclose his close personal friendship with Executive and disclosed confidential information about the CEO search, which he may have done to influence the CEO search to Executive's long-term advantage. As a result of this conduct, the board determined that Craigie violated his obligations of confidentiality and candor under the code of conduct.

The board determined that Craigie was no longer considered independent, which was disclosed in the 2023 proxy statement.

Craigie sent handwritten note to executive during SEC investigation

In March 2023, the SEC was investigating the friendship, and Craigie was aware of the investigation. Despite a document retention notice from the company and an instruction not to communicate with other parties, including Executive, Craigie sent a letter to Executive discussing matters relevant to the SEC's investigation, and indicating Executive should discard the letter after reading it.

Alleged violations

In its 2021 and 2022 proxy statements, Church & Dwight identified Craigie as an independent director because it was unaware of his relationship with Executive, due to Craigie's failure to disclose his relationship with Executive. As a result, the SEC alleged proxy statements in 2021 and 2022 contained misstatements of material fact when they listed Craigie as an independent director.

The SEC alleged that Craigie violated the proxy disclosure provisions of the federal securities laws, including Exchange Act Section 14(a) and Exchange Act Rule 14a-9.

RELATED PRACTICE AREAS

- Securities & Corporate Governance
- Securities Litigation and Enforcement

MEET THE TEAM



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