A Lawyer’s Job in Advising the Board

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Presentation to Association of Corporate Counsel

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Discussion Topics

- Board Meeting Best Practices
- Preparing Effective Board Minutes
- Director Independence and Disinterestedness
- Internal Investigations
- Duties of Directors
Board Meeting Best Practices
Role of Counsel in Promoting Best Practices

- **Procedure:** Help directors understand the appropriate procedural issues and the importance of using the proper procedure to accomplish board tasks

- **Confidentiality:** Exercise vigilance in ensuring that board meetings are confidential, especially when using technology to facilitate remote meetings

- **Oversight:** Observe conduct at meetings to ensure that they efficiently and effectively demonstrate oversight of the corporation’s affairs
Role of Counsel – Who is the Client?

- In-house counsel’s ultimate client is the Board of Directors as a whole – not management or individual directors
- Although in-house attorneys usually act at the direction of corporate insiders, this is a delegation of the Board’s power
- In-house attorneys must make their role clear at all times, and they cannot act as both attorney and client
Role of Counsel – Counsel as Director

- In-house counsel who serve as directors wear three hats: lawyer, employee, and director

- When the roles conflict, the ethical rules governing inside counsel as a lawyer control

- Note that courts give heightened scrutiny to the acts of attorneys who serve as directors
Following Appropriate Procedures

- Be familiar with the requirements of the corporation’s charter, bylaws, and determinations regarding:
  - Notice of Meetings
  - Quorum
  - Voting
  - Director Fees
  - Indemnification and Exculpatory Procedures
- Be able to discuss how having good processes and procedures helps protect the directors
Know Best Practices (That Protect from Liability)

- Independent judgment
- Active board involvement
- Regular face-to-face meetings of directors
- Regular evaluation of the CEO
- Regular executive sessions
- Careful review of disclosure documents
- Active monitoring of compliance programs
Board Focus – Strategy & Risk

- Recent trends for Board to review strategy and the corporation’s risk profile
- Board needs to understand:
  - Assumptions upon which strategy is based
  - Risks inherent in the strategy
  - Evaluate probabilities of strategy success or failure
  - Possible alternatives if the strategy does not meet expectations
  - Relation of strategy to organizational dynamics
Shareholder Communication & Engagement

- In the new normal, shareholder communication and engagement will be of greater importance.
- Boards and managements of public companies need to review and assess their capacity for shareholder communication and dialogue
Shareholder Communication & Engagement

Culture, Attitude & Information

- Is the corporation cultivating the appropriate culture and attitude for healthy and productive shareholder engagement?
- Does both management and the board understand the new reality of pending changes and heightened pressures?
- Does the corporation view its public filings as an opportunity to communicate with shareholders – not merely a compliance burden?
- Is the corporation doing all it can to provide transparent, relevant information to shareholders and avoid boilerplate?
- Is the corporation using new technologies to engage with shareholders?
- In instances where board decisions diverge from the known priorities of a significant segment of shareholders, is the corporation doing all it can to explain the rationale for the decision? Has it considered what other information shareholders may need to understand the situation the way the board views it?
Special Quorum Issues

- Certain circumstances require a special quorum, such as a quorum of independent directors

- Examples:
  - Dismissing a derivative suit under certain statutes
  - Complying with regulatory requirements, such as industry-specific regulations
Protecting Confidentiality – In-Person Meetings

- Consider collecting documents and notes at the end of the meeting
- If you destroy documents/notes, be consistent in how this is done
- Limit non-board attendees, especially for highly regulated industries
- Excuse non-directors when they are not needed
- Make thoughtful determinations with respect to the attendance of non-committee board members at committee meetings
Protecting Confidentiality – Telephonic Meetings

- Prefer in-person meetings when possible
- Do not use the same dial-in every time
- Use web-based viewing programs (e.g., Cisco WebEx) to view draft documents, rather than circulating in advance
- Log who attends the call/WebEx, if the system permits
General Considerations to Help Ensure Oversight

- Encourage all directors to speak on important issues
- Require adherence to parliamentary procedure – require votes on important issues
- Record votes and decisions
- Keep effective minutes
Addressing Domination

- Domination by management or a strong director can lead to significant potential liability for the board

- Ways to address this problem:
  - Provide a periodic update to the board on cases of director liability to call their attention to their duties and risks for failing to accomplish those duties
  - Consider requesting a presentation by your outside counsel to provide an external impetus for attention to governance issues
Preparing Effective Board Minutes
Role of Counsel as Corporate Secretary

- Counsel is often called upon to fill the role of corporate secretary and draft minutes of board and committee meetings

- Understanding what should be included as the amount of necessary detail is essential to protecting the board
  - Too little information can harm a board by failing to recount its actions and demonstrate oversight
  - Too much information can harm a board by opening it up to undue criticism or waiving privilege
Guiding Principles for Effective Minutes

- Minutes serve various purposes:
  - Protect board by demonstrating oversight
  - Hold management accountable to board directives
  - Provide a historical roadmap for diligence and legal opinion purposes
- Length of the minutes with respect to any particular subject should correspond to the importance of the matter
- Privileged discussions should be noted as privileged and otherwise not detailed in minutes
- Including the he said/she said of discussions is appropriate only in rare circumstances
Information to Include in All Minutes

- Date, Location, Time meeting began/ended
- Directors in attendance
- Others in attendance at invitation at board
- Time at which individuals left or were excused
  - Demonstrates that privilege was preserved during privileged discussions
  - Also records quorum for purposes of board votes
- Any votes or decisions made
Director Independence & Disinterestedness
Attorney Roles in Independence Determinations

- Boards look to counsel to assist them in determining director independence:
  - When selecting board members
  - When establishing a committee of independent directors to evaluate a transaction or litigation
  - When considering a response to a shareholder demand
Independence is Context-Specific

- For publicly-listed companies, the stock exchanges provide bright-line rules that help define "independence" for the purposes of listing.

- A director can be independent under the rules of the company’s stock exchange and not independent for the purpose of a specific committee or shareholder demand.
Defining Independence

- The inquiry into independence focuses on impartiality and objectivity as to a specific person, transaction, or litigation.
- Delaware law defines a director as independent when “he is in a position to base his decision on the merits of the issue rather than being governed by extraneous considerations or influences.”
Defining Independence

- Texas law (Tex. Bus. Org. Code § 1.004) defines a director as independent when:
  - they are disinterested,
  - they are either:
    - not an associate or member of the immediate family of the party/entity that is under concern, or
    - they are an associate of an entity under concern, but only as a governing person of it or its subsidiaries/associates;
  - they do not have a business, financial, or familial relationship with a party that is the subject of the claim or challenge that could reasonably be expected to materially and adversely affect their judgment;
  - they are not shown, by a preponderance of the evidence, to be under the controlling influence of a party that is the subject of the claim or challenge.
Independence in a Derivative Lawsuit

- The level of scrutiny board decisions face in derivative litigation is often dependent on the independence of the decision makers.
- Whether independence existed is typically reviewed prior to a review of the decision on the merits.
- The standards and procedures for determining director independence in derivative suits are state specific.
Delaware Law: Independence of a Special Litigation Committee

- The independence of a SLC is tested at the time that it moves for dismissal.
- The SLC carries the burden of demonstrating its independence, good faith, and reasonableness.
- Plaintiffs are entitled to discovery into these issues.
Choosing Independents for a Special Litigation Committee under Delaware law

- If no demand has been filed, object to the lack of demand *before* forming the committee or vesting an existing committee with full board power
- Once you have objected, vest the committee with full board power before starting an investigation
- If possible, use members of the board who were present at the time of the complaint/petition
- Avoid a one-person committee if possible; one-man committees are heavily scrutinized and must be beyond reproach
Internal Investigations
Internal Investigations: The Basics

- An internal investigation is launched by a corporation for various reasons, including:
  - To help a corporation avoid or limit possible criminal or civil liability exposure and correct significant problems
  - To evaluate concerns raised in a derivative suit
## Internal Investigations: Risks and Rewards

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<th>Risks</th>
<th>Rewards</th>
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<tr>
<td>Potential liability upon disclosure of findings</td>
<td>Retain process control; help develop defenses/responses</td>
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<td>Can delay statements/cause restatements</td>
<td>Proactive approach can minimize negative PR</td>
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<td>Impact on employee morale</td>
<td>Satisfies fiduciary duties</td>
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<td>Can make concurrent regulatory investigations protracted</td>
<td>Can lower risk of future events by strengthening controls</td>
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Stages of an Internal Investigation

**Stage 1:** Define the investigative objective, establish preliminary parameters of the investigation and consider ethical issues (e.g., scope of representation and privilege)

**Stage 2:** Coordinate the primary internal investigation participants

**Stage 3:** Develop the facts through effective document management and witness interviews

**Stage 4:** Analyze and evaluate the internal investigation’s findings

**Stage 5:** Determine and take affirmative steps toward the execution of necessary remedial action
Stage One: Set the Pace

- Clearly define the scope of investigation
- Develop a comprehensive investigative plan
- Communicate as necessary with the relevant parties
Stage Two: Coordinate the Players

- **Threshold Issue:** Determine if, given the issue(s) involved and the related implications, the internal investigation can be conducted by in-house counsel or whether outside counsel should be engaged.

- **In-House Counsel:** Where the allegation of misconduct is not widespread and the in-house legal department is not implicated, the investigation may be conducted by in-house counsel who are familiar with the corporation and its programs.
Stage Two: Coordinate the Players

- **Outside Counsel**
  - In situations where senior officers, board members, or the legal department is implicated, the investigation should generally be conducted or overseen by outside counsel.
  
  - If outside counsel is chosen, depending on the nature of the allegations, the corporation may want to select independent outside counsel and not hire a law firm that has historically handled the corporation’s business or with which the corporation has a working relationship.
Stage Three: Develop an Accurate Factual Chronology

- Consider engaging/engage experts
- Gather and review documents
- Conduct witness interviews
Stage Four: Analyze Investigative Findings

- Benefits and risks to preparing a written report
- Waiver considerations and risks in sharing findings with full board
Stage Five: Take Action

- Critical distinction:
  - Mandatory steps versus optional actions

- For example, with respect to disclosure:
  - May be mandatory under applicable laws, settlement agreements, or under self-reporting obligations
  - May be voluntary to promote corporate leniency or lessen charging/plea negotiations with the government
Stage Five: Take Action

- Considerations for taking other remedial action:
  
  - **Rewards**—Taking action may result in limited government action, reduction in sentencing, prevention of recurrence, or repairing public image
  
  - **Risks**—Admission of wrongdoing or lack of controls, costs may outweigh benefit, remedies may be difficult to effectuate or maintain
  
  - **Timing**—Illegal conduct must be ceased immediately while other problems may be better to fix post-investigation

- Coordination with government/regulators
Duties of Directors
Two Main Duties

- Under Texas law, directors owe fiduciary duties to the corporation and its shareholders:
  - **Duty of Care** – directors must exercise diligence and prudence in managing the corporation’s affairs
  - **Duty of Loyalty** – directors must avoid conflicts of interest
- “Good faith” has long been an element of directors’ fiduciary duties
  - Most often associated with duty of loyalty
  - Also relates to duty of care
Duty of Care

- Directors must be well-informed and diligent
- Decision-making process must be thorough
- Reliance on management and financial or legal advisors must be reasonable
Duty of Care

- Business Judgment Rule
  - Protection from liability when directors act with diligence, in good faith and without self-interest
  - Operates as a presumption that directors have satisfied their duty of care as long as there is a rational business purpose for their actions
  - A court cannot generally "second-guess" a board's business decisions, even in the case of manifestly bad decisions
Duty of Care

- Making Decisions Under the Business Judgment Rule
  - To get protection of the business judgment rule, it is important to make decisions – e.g., a decision about whether the information flow is adequate
    - Texas has not adopted a standard for director oversight
    - Delaware law does not protect directors’ oversight role when no affirmative decision is made: a “sustained or failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability”
  
  See Caremark, 698 A.2d 959 (Del. C. 1996)
Duty of Care

- Protection of Directors in Corporate Charters
  - Most companies have adopted director exculpation provisions in their corporate charters

- These provisions generally bar damage claims against directors as long as they:
  - do not have a conflict of interest,
  - act in good faith, and
  - did not receive an improper personal benefit even if they acted with gross negligence.
Duty of Loyalty

- The Duty of Loyalty requires directors to:
  - Act in good faith
  - Act in the best interests of the company and all of its shareholders
  - Avoid conflicts of interest

- If a director breaches her duty of loyalty, she is not entitled to exculpation
Duty of Loyalty

- Controlling shareholders also have Duty of Loyalty
  - As shareholders they may act and vote in their own economic self-interest
  - But their director designees owe fiduciary duties to minority shareholders
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