

D&O LIABILITY

Who Is My Lawyer When Disputes Arise in the Boardroom?

The following is the first in our series of *directorthink* articles.

Most of the time, a company's board, senior management, general counsel, and outside counsel work as a team. After all, each has a duty to serve the company's interests. In fact, directors and senior management often consult with company counsel on matters and decisions that may materially impact the company and them.

But what if a conflict arises among all or some of these parties and these interests are no longer aligned? Conflicts arise among directors and between directors and members of management, counsel, and other constituencies (e.g., stockholders, creditors or employees). Conflicts arise over company strategy, control of the company, management's role, actions or compensation, and proposed transactions with management, stockholders, or directors, among other issues. Conflicts are a natural part of corporate interaction (and if handled properly can actually benefit the company). The danger is they will not be appropriately addressed.

When conflict arises, directors should remember that, although they may enjoy a good relationship with company counsel, and may previously have received valuable advice from such counsel, *in a conflict situation, the company's general and outside counsel represent the company, not the board or any individual director.*

Company counsel owe strict ethical and legal duties to their client. Also, these lawyers may, under certain circumstances, be required to report misconduct "up" (to sources within the company) or "out" (to sources outside the company). These obligations mean that in a conflict between a director and the company, company counsel must side with the company and may not be able to counsel the director on his or her full array of legal options. In certain circumstances, a director's discussion with company counsel may not even be protected by the attorney/client privilege.

Directors must remain alert for situations in which their legal interests conflict with those of the company. In those situations, separate counsel may be needed or a special committee composed of non-conflicted directors, with its own counsel, may need to be established. Below are examples of such situations:

- *If a director is personally named in a lawsuit.* Although combined representation of all or some directors and/or the company may ultimately be

deemed appropriate, a director should consider separate counsel. The director's interests in the suit may be different from or conflict with those of the company or other directors; therefore, a different defense may be appropriate, and the director's admissions to company counsel may not be protected by the attorney/client privilege until company counsel formally represents the director.

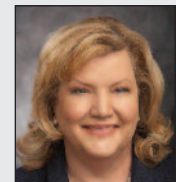
- *If an independent committee is established.* An independent committee may be established to review a transaction or takeover bid involving an interested member of management or a director to provide protection against the perception of a conflict (e.g., the perception that management directors are incapable of impartially evaluating any takeover bid) and to determine whether the company should pursue a legal claim instituted by a shareholder on behalf of the company (a shareholder derivative lawsuit). These committees should have separate counsel to advise them on the applicable state law processes, procedures and duties. Standing independent committees (e.g., audit and compensation committees) may also retain independent counsel. For example, some audit committees retain separate counsel to preserve the integrity of their review of financial processes.

- *When a director (who may also be an officer) negotiates his or her compensation or employment agreement.* In such negotiations, company counsel must protect the interests of its client, which are in conflict with those of the director.

- *If a director believes there has been fraud, mismanagement or misconduct by management, including any violation of the company's code of ethics.* Although company counsel may not have an apparent conflict, separate counsel may avoid any implication of influence by management in the review process. This could be important if, for example, the committee finds no mismanagement occurred and that conclusion is later challenged in court.

Ultimately, directors should consult separate counsel when in doubt. If the actions of other directors or senior management make a director uncomfortable, or if he or she fears the company's best interests are not being served or his or her personal interests are in conflict with those of the company or other directors then consultation with separate, independent counsel is a must.

In a conflict situation, the company's general and outside counsel represent the company, not the board or any individual director.



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