# THE INS AND OUTS IN HANDLING DIFFICULT BOARD MEETINGS — PRACTICAL TIPS FOR LEGAL ADVISORS

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## 1. INTRODUCTION

1.1 Scope of Outline. This outline focuses on problems that corporate lawyers often encounter in board of directors meetings when difficult legal and business issues and difficult board members have to be dealt with in an effective manner. Corporate management usually leans heavily on legal counsel in finding prudent ways to handle problems that can arise inside the board room. The ins and outs of advising clients on these kinds of matters requires carefully thought-out business and legal advice. Unfortunately, difficult decisions for a board can arise so quickly that there is little opportunity for any advance preparation. For these reasons, corporate lawyers are well advised to have a set of guiding principles that they can follow regardless of the circumstances. Without doubt, shepherding management and directors through difficult problems is never an easy task for legal counsel. The purpose of this outline is to give practical suggestions to legal advisors for addressing problems in the boardroom.

1.2 Texas and Delaware Law. Where appropriate, this outline points to Texas and Delaware statutes that are particularly relevant to the issues discussed below. With respect to pertinent case authority, it should come as no surprise that most cites in this outline are to Delaware cases due to the sparsity of Texas cases dealing with corporate law issues.

## 2. DEALING WITH DIFFICULT BOARD MEMBERS IN THE BOARD ROOM

2.1 Overview. The task of advising a board of directors, in addition to requiring substantive legal knowledge, requires some degree of skill at interpersonal relationships. As with any group of individuals, a board of directors has its own personality that is in some way reflective of the strengths and weaknesses of each of its members. The attorney's challenge is to make certain that each of those members, with their particular and sometimes peculiar traits, is able to act in an informed manner and is able to make a decision that is consistent with the interests of all stockholders. This task can be complicated when one or more directors attempts to impose upon the group his or her particular agenda or world view.

In the past few years, courts, the Securities Exchange Commission and active institutional shareholders have all brought a renewed focus on issues of corporate governance. See e.g., Richard H. Koppes, *Barriers to Good Corporate Governance*, Corp. Governance Advisor (March/April 1999); Bruce Hiler & Ira H. Raphaelson, *When Reasonable Reliance Isn't Enough: The Evolving Standards For Board Oversight*, 12 No. 1 Insights 2 (Jan. 1998); A. Gilchrist Sparks, III and S. Mark Hurd, *Special Committees of Directors - When Does the Business Judgment Rule Apply and To What*

*Extent Are Committee Proceedings Confidential*, 2 Del. L.R. 215 (1999). Perhaps the most concrete example of this reexamination is the SEC's formation of a Blue Ribbon Panel to explore the role of audit committees. Martin Lipton, et al., *Audit Committees - Some Observations*, 1156 PLI/Corp. 739 (Dec. 1999). In addition, high dollar, high profile cases have stressed the important role of compensation committees. See *In re Walt Disney Co. Deriv. Litig.*, 731 A.2d 342 (Del. Ch. 1998); and *Sanders v. Wang*, 1999 WL 1044880 (Del. Ch. Nov. 8, 1999). Given the intense scrutiny that boards of directors are likely to face when a board decision is challenged, it is all the more important that each director act in a professional, disinterested and informed manner.

Of course, the framework for any discussion of director behavior is the business judgment presumption. The law will protect a board's decision if that decision is made in an informed manner and in a manner untainted by the personal interests of any majority of its directors. Even if one assumes that it is always a director's intention to fulfill these duties of care and loyalty, most corporate lawyers have encountered situations where a particular director behaves in a manner that is counterproductive to making an informed or disinterested decision. Although each director is unique, it is possible to observe problematic traits that are common to directors on various boards. This outline attempts in a most unscientific manner to discuss these traits and to offer measures for preventing obstacles to productive board meetings. Offered below are sample profiles of directors and boards that may be more prone to such behavior.

2.2 Director Profiles.

2.2.1 The Founder. When an entrepreneur builds a company from scratch and then invites in outside investors or takes the company public, he or she may continue to think of the company as his or hers alone. This inability to let go manifests itself in three primary ways. First, the founder director may have a tendency unilaterally to make decisions that are more appropriately made by the board of directors. Second, the founder director may attempt to control every board decision by limiting the board's information or options. Third, the founder director may feel entitled to continue to be specially rewarded for starting the enterprise.

The optimal way for a practitioner to deal with a founder director is to make certain that these tendencies do not develop in the first place. It is imperative that the lawyer educate the founders regarding fiduciary duties before bringing in equity investors. As with any board of directors, this orientation program should be more than a simple statement of the principles, but should instead be a detailed tailored exposition of the importance of following the processes recommended by Delaware law.

But not all of us are so lucky as to be there at the time of the inception of the board, so how do we deal with a firmly entrenched founder director who continues to treat the company as his or her own? First, it is never too late to educate. Find an appropriate occasion such as an annual board meeting or board retreat to review with the directors their fiduciary responsibilities. Second, assuming such a review is not welcome or not feasible, there may be opportunities to remind directors individually or as a committee about their fiduciary responsibilities and specifically about their personal duty to exercise oversight of the company's operations.

2.2.2 The Fraternity. It is natural that some number of directors on almost every board have personal or business relationships outside of the board room. Directors choosing replacements are concerned that the candidates be capable and well respected individuals, and they often choose persons known to them rather than persons who are not. However, a board consisting of family members or close business associates can, depending on the particular circumstances, destroy the integrity of a board decision. See *Kahn v. Tremont*, 694 A.2d 422 (Del. 1997); *In re NVF Co. Litig.*, 1989 WL 146237 (Del. Ch. Nov. 22, 1989).

The most important thing that a legal counselor can do in advising a closely connected board is to make certain that the directors acknowledge the existence of their relationships and understand the potential for conflict. If you are successful in leading the directors to an understanding of the ramifications of the various relationships among directors, solutions such as adding outside directors and establishing independent committees should flow naturally.

2.2.3 The Actor. Persons agree to serve on boards of directors for many reasons, both personal and business-related. Regardless of their motivation, it is important that directors recognize the gravity of their position and their decisions. Some directors are enamored of the prestige or ancillary business benefits appurtenant to being a director of a company, but when faced with the prospect of doing real work in connection with a major decision, they are unwilling to put forth the requisite effort. These same directors are more than likely those that are primarily concerned with protecting themselves from liability, especially in times of crisis.

Most boards have directors who contribute less than their fellow directors, and while it would be ideal if every director participated fully, as a practical matter a board is able to function despite these laggards. The problem of directors who only want to play the part is perhaps more acute in the special committee situation, where each director should understand fully his or her role and the committee's decision, and where it is likely that each of the committee members will be deposed in any litigation. The obvious solution is to take whatever steps available to prevent the appointment to a special

committee of those directors who are not willing to devote the necessary energy to the work of the committee.

2.2.4 The Artist. Although it is a practice to be avoided, certain directors are added to boards not for their business acumen, but for their marquee value. As an example, in a deposition preparation session, a prominent member of the entertainment community was asked to describe his fiduciary duties. He stared at the ceiling for a moment and then looked at his lawyer seriously and stated: "You know, I have always considered myself the creative force on the board." Needless to say the lawyer spent the next two hours helping him articulate his understanding of his duties. The lesson to be learned is that no matter how sophisticated a director may appear to be, and no matter how many times you have done so before, it pays to review the basics before every decision.

2.2.5 The Lawyer. Asking a partner in a company's local law firm to join the board of directors presents myriad possibilities for conflict. Nevertheless, some companies continue to believe that the benefit of having an experienced legal practitioner on the board of directors outweighs the potential difficulties. Advising a board that includes a lawyer-member can present special political challenges. The natural tendency of the lawyer director will be to second guess the outside legal advisor, which can be at times both productive and counterproductive. It is on the one hand helpful to have any board member spur on a more detailed discussion when the board is faced with an important decision. On the other hand, a lawyer director who, feeling that his firm's position as primary legal services provider is somehow threatened, becomes a constant contrarian does not serve the interest of the board. The outside lawyer in this circumstance should suggest to the lawyer director that the more extended debate on the legal issues take place outside the context of the board meeting.

2.2.6 The Representative. A director, no matter by whom designated, elected or appointed, owes fiduciary duties to all stockholders equally. The issue of directors serving many masters is a difficult one that is often overlooked. It also is an issue that is highly fact specific. For example, a director employed by a majority stockholder may assert the control rights of his or her employer in a board's decision-making process, but also has a fundamental duty to be fair to the minority stockholders. See *McMullen v. Beran*, 1999 WL 1135146 (Del. Ch., Dec. 1, 1999). On the other hand, a director whose employer owns 5% of a widely held company is not privileged under the law to favor his employer's personal interests over those of the stockholders generally. Yet a third fact scenario is the company that has several large stockholders who have the right to designate directors pursuant to a shareholders agreement, but that also has several small unaffiliated stockholders. The directors in this circumstance often believe that if they satisfy the interests of all of the signatories to the shareholders agreement,

they have fulfilled their duties; in fact, they owe duties to all shareholders, whether or not signatories to the shareholders agreement.

In counseling boards of directors that include members who represent large stockholders or particular classes of stockholders, a lawyer should be conscious of three guiding principles. First, directors qua directors owe the same duties to each stockholder. Second, a director who owns stock or is employed by an entity that owns stock may exercise his or her rights as a stockholder or his or her employer's rights as a stockholder in his or her absolute discretion. See *Heil v. Standard Gas & Elect. Co.*, 151 A. 303 (Del. Ch. 1930). Thus, for instance, a majority stockholder who is a director may veto any acquisition proposal, regardless of how attractive to the minority stockholders. See *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840 (Del. 1987); *McMullen v. Beran*, 1999 WL 1135146 (Del. Ch. Dec. 1, 1999). Third, it only takes one stockholder to challenge a transaction as unfair. Thus, despite the fact that the directors may represent a large majority of stockholder interests who favor a particular transaction, if one shareholder whose interests are not specifically represented on the board determines that the transaction is not fair, the transaction is subject to challenge.

2.2.7 The Super CEO. Every company wants a CEO who is a star performer, but the Super-CEO director can dramatically change the dynamic in the board room. The natural tendency of the board is to want to encourage the high performing CEO to continue to perform. Hand in hand with this tendency to encourage is a tendency to defer to the judgment of the CEO, because he or she apparently has hit on the right formula. Finally, the Super-CEO can develop a belief that he or she is entitle to reap extraordinary benefits due to the superior performance. These tendencies are, like many things, only dangerous if they become extreme. The directors should be reminded of their duty to think independently and their important duty of oversight. See *In re Caremark Intern. Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996) ("*Caremark*"). The CEO must be encouraged not only to continue to perform, but to use the board as a resource for business guidance.

2.2.8 The "Dissident" Director. When one member of a board of directors begins pushing an agenda different than the remaining directors, there is little a board may do to frustrate the adversarial director's campaign. The most obvious method for working around a "dissident" director is to establish an executive committee. Under Section 141(c) of the Delaware General Corporation Law, a board of directors may create and rely upon committees to take all but a handful of environmental board actions. This right is subject to abrogation by the Certificate of Incorporation or bylaws. Using an executive committee to make decisions acts as a shield to adversarial directors. However, the shield is not complete; every director has a virtually unfettered right to review the books and records of the company. See *Belloise v. Health Mgmt.*, 1999 Del. Ch. LEXIS

127 (June 11, 1996) (transcript of oral ruling). Upon demand, the company must give the dissident director any company materials requested, including notes or minutes of any executive committee meetings. On the other hand, if the dissident is running a competing slate in a proxy contest, the board may withhold strategic material relating to the contest.

2.3 Basic Advice In Dealing With Difficult Directors. There is no specific formula for the often complex task of advising a board of directors which may include problematic members, but there are a few practices that will optimize the chance that the directors will receive, understand and appropriately use legal advice. Set forth below are four basic points to follow.

2.3.1 Keep The Focus On The Fundamentals Of Fiduciary Duties. Always begin with the basics. No matter how repetitious it may be, it will always pay to review with the directors their fundamental fiduciary duties under Delaware law.

2.3.2 Deal With Conflicts Up-Front. Encourage a discussion of conflicts or potential conflicts at the beginning of a decision-making process. Not only does this practice create an important record, it also often results in directors recognizing and acknowledging conflicts that they may not otherwise have considered.

2.3.3 Educate Your Directors. To the extent possible, make certain that the directors are well oriented. Initial or annual orientation or retreat programs are an opportunity to review fiduciary duties and to deal delicately with undesirable board dynamics.

2.3.4 Insist On Active Participation. Encourage active committees. This is imperative given the *Caremark* decision and the SEC's emphasis on audit and compensation committees. See *Caremark*.

## 3. DEALING WITH DIFFICULT ISSUES IN THE BOARD ROOM

3.1 Overview. Serving on a board of directors is not always a "walk-in-the-park." Directors are often confronted with complex and demanding business decisions that raise significant issues regarding their fiduciary duties. Furthermore, a board's efforts to carry out its duties can be hampered by the fact that it must act under great time pressures. When directors face circumstances that can expose them to considerable legal risks, corporate counsel will be called on to offer careful guidance in the proper exercise of their duties

3.2 Special Circumstances That Make for Special Problems in the Board Room. Set forth below is a brief analysis of the legal aspects of certain corporate actions that can present special problems for boards. A board's decision making process and the related corporate action taken can often precipitate subsequent litigation challenging director conduct. In that regard, the fiduciary duties of the directors and the standard of judicial review that the courts will apply will be critical to the advice that legal counsel will provide the board before it acts. Needless to say, the preparation for a board meeting and the manner in which it is conducted will be driven by the objective of complying with the applicable legal duties and standard of judicial review. From a practical standpoint, legal counsel to a board will first want to analyze the corporate action contemplated to be addressed by the board to determine the applicable duties and legal standards. Then working backward, counsel will design the steps that the directors need to take in building a record that will show the board acted properly. With that in mind, the discussion below focuses on what will be expected of directors in fulfilling the duties of care, loyalty and disclosure in the context of certain corporate actions that have produced noteworthy legal decisions over the past two decades.

3.2.1 Approving Corporate Takeover Transactions. Whenever a board of directors acts on a takeover proposal, different fiduciary duties can be triggered depending on the circumstances. For instance, a board's duty in the case of a stock-for-stock merger of equals will be different from the duties imposed on a board in a merger that effectively involves a change of control. Below is a discussion of the legal duties that directors must adhere to in the boardroom in connection with taking certain actions in merger and acquisition transactions and the corresponding standards of review utilized by the courts.

(A) Approving A Strategic Merger: Duty of Care / Business Judgment Rule. The courts historically have given judicial deference to the decision making of directors. The reluctance of courts to second-guess the business decisions of boards is based on the belief that boards are more qualified than courts to make such decisions. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971). Also, there is a belief that to expose directors to liability for ordinary mistakes in judgment would discourage qualified individuals from serving as directors. In keeping with this policy of judicial deference to boards of directors, courts in most jurisdictions have granted directors protection by establishing what has become known as the business judgment rule. This rule essentially says that in the courtroom, defendant directors will have the benefit of the presumption that they acted (i) on an informed basis, (ii) in good faith and (iii) in the honest belief that the challenged transaction was in the best interest of the corporation. See *Unocal Corp. v. Mesa Petroleum Co.* 493 A2.d 946, 954 (Del. 1985) *Citron v. E.I. DuPont de Nemours & Co.*, 504 A.2d 490, 499 (Del. Ch. 1990). To rebut this rule, a plaintiff has the burden of proof of showing that the directors either failed to

exercise good faith, loyalty or due care. See *Cede & Co. v. Technicolor Inc.*, 634 A.2d 345, 361 (Del. 1993). Practically speaking, a plaintiff must demonstrate that the directors were guilty of gross negligence in order for the directors to be found culpable for an alleged breach of the duty of care.

So, what must a board do to demonstrate that it has exercised due care in making a corporate decision? In examining the conduct of directors in approving an acquisition by a friendly suitor, the Delaware Supreme Court in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) concluded that the duty of care is satisfied when a board follows a decision making process that a reasonable person would follow under the same circumstances. The court indicated that this requires directors to become fully informed, to ask questions and scrutinize matters and to carefully deliberate the issues before making their decision. Most assuredly, the process by which directors evaluate and act on a matter will be the judicial focus in determining whether they have satisfied the duty of care. In that regard, while corporate statutes grant directors the right to rely upon information, opinions and reports of management and experts, a board cannot totally delegate their responsibilities in evaluating a matter but must take an active role especially in the case of significant matters like the sale of the company. In sum, board decisions must be made on a fully informed and carefully considered basis.

Issues for the Boardroom. A reasonable decision making process will largely be driven by the nature of the corporate action under consideration. By way of illustration, take the case where a board is considering a proposal to be acquired. In acting on any acquisition proposal, there will be many steps taken in fulfilling the duty of care (i.e., becoming fully informed, making due inquiry and deliberating the issues). For instance, what should the board do in determining whether the proposed price is fair? Should an investment banking opinion be obtained as to the fairness of the transaction? To what extent should the directors rely on the opinion of experts in making its decision? Are there any company personnel beside senior management that the board also should seek input from? How thoroughly should the directors read drafts of lengthy legal documents in order to demonstrate proper care? What about relying on written summaries of documents? What information should be given to the board in advance of meeting? How much time will the directors need for reviewing information in order to be adequately informed? What questions should directors ask management and experts? To what extent should the board consider other alternatives for maximizing stockholder value? How much should the board probe into the presentations made by management and experts? What are the major risks in the proposed transaction and can the board prudently accept those risks? These are also the kinds of issues that legal counsel must take into account when preparing directors for the task before them.

Inside the boardroom, there are no hard and fast rules and procedures as to what issues a board should address and what course of action it should take to exercise due care. The specific circumstances will dictate what a reasonable person would do. In that regard, reasonable business people will take risks in business transactions and thus, that should be no less true of directors in representing the interests of the stockholders and the corporation. Accordingly, since so many transactions brought before a board will have risk issues, directors need to recognize that in complying with the duty of care, a board can take prudent risks that are based on their informed business judgment.

While input and guidance from others is important, a board should not be blindly led by management and advisors. Instead, a board must exercise its own initiative in deciding what steps should be taken to become fully informed and to consider and deliberate the matter in a prudent manner. In that regard, while director decisions or the steps taken by them to make an informed decision may be second-guessed in litigation challenging the action taken, their reasonable choice of steps in arriving at a fully informed and carefully considered decision will be protected by the business judgment rule. *Solash v. Telex Corp.*, [1987-1988 Transfer Binder] Fed. Sec. L. rep. ¶ 93, 608 at 97, 727-28 (del. Ch. Jan. 19, 1988).

(B) <u>Approving a Sale of Control: Revlon Duties</u>. In *Revlon Inc. v. Mac Andrews & Forbes Holdings Inc* ., 506 A.2d 173 (Del. 1986), the Delaware Supreme Court held that once it is inevitable that a company will be sold or will be subjected to a "break-up," its directors have a duty to secure the "best value" practicably available to the stockholders. Subsequently, the Delaware courts have more clearly articulated the circumstances by which the *Revlon* duties will be triggered. The courts have held that putting a company up for sale does not trigger *Revlon* duties unless the proposed transaction will result in a change of control. See *Paramount Communications Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989) (a change of control not found in a proposed merger because before and after the stock-for-stock merger the corporation was to be owned by a "fluid aggregation of unaffiliated stockholders"); *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1993) (a change of control was found in a proposed merger by reason of the transfer of control from the public shareholders of the corporation to a controlling stockholder of the surviving entity); *Arnold v. Society for Savs. Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994) (no change of control found).

<u>Issues for the Boardroom</u>. When considering the approval of a negotiated deal, a board must decide whether the proposed transaction and the related circumstances have triggered the *Revlon* duties. In the boardroom, the first question to be asked is obvious "Has the board committed itself to a sale or break up of the company?" Next, if it is a stock-for-stock merger, a careful analysis of stock ownership and control of the company before and after the transaction will have to be made to see if a "change of control" would

occur. If these issues are answered in the affirmative, under *Revlon*, the board must seek the best value available rather than only considering the one proposed transaction.

Of course, in the case of a proposed all cash deal, a board of directors will also be hard pressed to justify not conducting an auction or at least a "market-check" for potential buyers before entering into that deal. Furthermore, as discussed in the next section, when the *Revlon* duties have been triggered, it can be perilous for a board to agree to protective measures that would foreclose the directors or stockholders from considering a subsequent superior bid. Bottom line, in the absence of special mitigating circumstances, once the *Revlon* duties come into play, a board must seek the best transaction available for maximizing stockholder values. And, in deciding between alternative opportunities for achieving that end, a board may consider many factors including the forms of consideration, the timing, the risks of non-consummation and the tax consequences.

(C) Adopting Defensive Measures In A Contested Takeover / Adopting Measures To Protect A Negotiated Deal Against Interlopers: Enhanced Scrutiny. As also noted below in Section 3.2.2 regarding "interested transactions," the courts have refused to grant directors the protection of the business judgment rule where the interests of directors and the stockholders are not aligned. In that regard, the courts have recognized that the interests of directors and stockholders may be different when a board adopts defensive measures in responding to a takeover bid or adopts measures to protect a negotiated deal against unwanted interlopers. In protecting the interests of stockholders, the Delaware courts have rejected the immediate application of the business judgment rule in those cases, and instead, have first applied a two-pronged standard of review (commonly called the "enhanced scrutiny test" or the "Unocal Test"), pursuant to which a board of directors has the burden of proving (i) that in adopting the defensive measures, it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed and (ii) that such defensive measures were "reasonable in relation to the threat posed." See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985); *Moore Corp. v. Wallace Computer Services, Inc.*, 907 F.Supp. 1545 (D. Del. 1999). The Delaware Supreme Court in *Unitrin Inc. v. American General Corp.*, 651 A.2d 1361, 1388 (Del. 1995) gave greater definition to the Unocal Test by holding that a defensive measure is reasonable so long as it does not preclude stockholder choice and does not coerce stockholder action and that the defensive measure does not fall outside a "range of reasonableness." *Id.* at 1387, 1388. If the directors are able to satisfy the *Unocal/Unitrin* standard, then the directors are afforded the protection of the business judgment rule unless otherwise rebutted by the plaintiffs.

Where boards have adopted measures to protect a negotiated deal, the Delaware courts have likewise applied the *Unocal/Unitrin* standard in judging the director's

conduct in doing so. Generally speaking, in the context of their *Revlon* duties, the courts will expect a board to provide a level playing field for all bidders. However, depending on the circumstances, the courts have upheld the adoption of reasonable measures for protecting a deal. See *Cinerama Inc. v. Technicolor Inc.*, 663 A.2d 1156, 1173 (Del. 1995); *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43 (Del. 1997).

Issues for the Boardroom. In adopting defensive measures like a stockholders' rights plan ("poison pill"), a stock repurchase program or a plan of recapitalization, a board must carefully evaluated the proposed measures in light of *Unocal/Unitrin* standards. To begin with, does the board have sufficient evidence that the proposed takeover threatens corporate policies? In that connection, the board should be in a position to demonstrate that it has a long-range corporate policy in place and that policy will be harmed by the proposed action. Practically speaking, a board's conduct in adopting a defensive measure should reflect a "good faith concern for the welfare of the corporation and its stockholders" under the circumstances. *Unocal* at 985. In that context, a defensive measure adopted in response to a hostile bid may be justified if in the exercise of its business judgment, the board concludes that the bid involves unacceptable elements such as (i) an inadequate price, (ii) coercive terms, or (iii) insufficient information for evaluating the offer. In considering the reasonableness of potential defensive measures, it will be important in the boardroom that the directors be presented with a thorough legal analysis of prior judicial decisions regarding factors that the courts have found can justify defensive measures.

To avoid being a "stalking horse" for other bidders, in entering into a negotiated acquisition agreement, the acquiror can be expected to push the target company for protective mechanisms such as (i) a "no-shop" provision (ii) stockholder agreements with a major stockholders and directors requiring them to vote in favor of the proposed transaction, (iii) stock options granted by the target company whereby the acquiror has an option to purchase stock (usually 19.9%) in the target at the current market price if a competing offer is successful and (iv) options ("crown jewel option") to buy specific assets of the target company. In the case of a strategic stock-for-stock merger of equals in which no one will be a controlling stockholder, a board can usually justify agreeing to mechanisms designed to protect the deal. On the other hand, adopting protective measures when *Revlon* duties have been triggered will be perilous at best.

In the case of an all cash deal or a stock-for-stock merger involving a change of control, how the courts view the directors conduct in agreeing to lock-up measures will be impacted by many factors including whether the board first conducted an auction or at least, a "market-check." Indeed, a "no-shop" covenant without a "fiduciary out" would be hard to defend in those cases. By the same token, it would be problematic for a board to agree to a "break-up" fee (payable in the event the "fiduciary out" is exercised) if the

fee amount would have an unreasonable "chilling" effect on competing bidders. Should it be capped? Indeed, the reasonableness of any lock-up mechanism must be carefully considered by a board in satisfying its *Revlon* duties.

Notwithstanding efforts by a board of a target company to negotiate reasonable protective mechanisms, the board may face a dilemma if a would-be acquiror gives an ultimatum that it will walk the deal if the target company does not grant the protective mechanisms asked for. When that occurs, the board will carefully weigh the risks of losing the proposed transaction against the likelihood of finding a better offer. If the board elects to give in to the ultimatum, the board should possess sufficient evidence to demonstrate the reasonableness of its actions under the circumstances. *Barkan v. Amsted Industries, Inc.*, 567 A.2d 1279, 1286-87 (Del. 1989).

3.2.2 Approving Interested Transactions. A fundamental principle of corporate law is that directors owe a duty of loyalty to their corporation. Under this duty, directors are required to act in the best interests of the corporation and to refrain from doing anything that would injure the corporation or deny it some benefit. Most importantly, as between the interests of the corporation and a director, the interests of the corporation must always come first. See *Cede & Co v. Technicolor Inc.*, 634 A.2d 345 (Del. 1993); *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939). Moreover, a director who engages in a transaction ("interested transaction") involving the corporation, has a duty to make the other directors and the corporation aware of the conflict of interest before any action is taken on that matter. See *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985). Because courts view self-dealing transactions with great skepticism, such transactions are generally given heightened scrutiny.

An interested transaction is generally viewed as (i) a transaction in which a director (or an affiliate) will receive a personal benefit not equally shared by the other stockholders or (ii) a transaction which would be detrimental to a director (or an affiliate) but not to the corporation. See *Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993). While they can take many forms, two examples of an interested transaction are: (i) when a director purchases from, or sells to, the corporation certain business assets and (ii) when a parent corporation (i.e., controlling stockholder) or a management team and certain board members propose a "going private transaction" with the corporation. Although Delaware has no corresponding statutory provision, the Texas Business Corporation Act defines "disinterested" in Art. 1.02(12). Furthermore, Section 144(a)(1) of the DCL and Art 2.35-1 of the TBCA generally provide that an interested transaction is protected if approved by a majority of informed and disinterested directors.

Corporate directors are especially vulnerable to attack when they approve an interested transaction involving a majority of the directors because in that situation, a

board is not afforded the protection of the favorable business judgment rule. See *Kahn v. Lynch Communications Systems Inc.*, 638 A.2d 1110, 1116 (Del. 1994). Instead, the standard of review for interested transactions applied by the Delaware courts required that such transactions meet the "entire fairness" standard. This means that the directors must prove that the challenged transaction was "entirely fair" to the corporation. (For a discussion of the "fairness" standard under Texas law, See *International Bankers Life v. Holloway*, 368 SW2d 567 (TX 1963).) In the context of an acquisition, this is an onerous standard to satisfy in the courtroom because it requires a showing that the corporation and its stockholder received a fair price and that there was fair dealing between the defendants and the corporation. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *Kahn v. Tremont Corporation*, 694 A.2d 422, 427 (Del. 1997). However, directors can gain a procedural advantage (shifting the burden of proof to the plaintiffs to prove that the challenged transaction was unfair) if they properly appoint and utilize a special committee of disinterested directors. See *Clash, Kahn v. Lynch Communications System Inc.: A Major Step Toward Clarifying the Role of Independent Committees*, 20 Del. J. Corp. Law 564 (1995); *Sparks, The Whys and Hows of Special Committees*, The M&A J. 44 (March, 1997). The steps for establishing and operating a special committee must be carefully followed before the directors can be entitled to this procedural advantage. The committee's formation and operation must, in fact, reflect integrity, true independence and real bargaining power in negotiating the transaction on an arm's-length basis on behalf of the corporation.

Issues for the Boardroom. When an interested transaction is proposed in the boardroom, the directors will first be faced with the task of determining who is, and who is not, a disinterested director. After all, the board will want to form a special committee of disinterested directors in order to obtain the greatest legal protection for the board and the transaction. Next, it will be essential that, if the special committee's conduct is to pass muster in the courtroom, the directors need to reach an understanding that the special committee must (i) act independently, (ii) be free from the influence of interested parties, (iii) retain only independent advisors (legal counsel and investment bankers), (iv) negotiate on an arm's length basis and (v) have the power to "say no" and walk away from the proposed transaction. If these kinds of factors are largely disregarded by the directors, the courts are likely to find the operation of the special committee to be fatally flawed.

In considering the issue of fair dealing, the special committee will want to be satisfied that the facts demonstrate that the timing of a proposed transaction and its structure are fair to the corporation and its stockholders. The disinterested directors will also want satisfactory guarantees that the interested directors have disclosed all material information to the whole board so that it can make a fully informed decision. The conduct of the interested directors and the disinterested directors (who make up the

special committee) will be closely scrutinized by the courts. The special committee must essentially evaluate and negotiate the proposed transaction as if it were the entire board. Without doubt, the way that the special committee discharges its duties will be outcome determinative.

3.2.3 Approving Internal Systems To Monitor Corporate Conduct. As a subset of the duty of care, the courts have recognized that directors have a duty to oversee the conduct of employees. Based on *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963), in the past, corporate counsel advised directors that they were entitled to rely on corporate officers to monitor corporate conduct and in the absence of suspicious conduct coming to their attention, the directors had no duty to go looking for wrong doing. This position appears on its face to be consistent with the statutory provisions of §141(e) of Delaware General Corporation Law ("DCL") and Article 2.41(D) of the Texas Business Corporation Act ("TBCA"). However, in 1996, the Delaware Chancery Court in *Caremark* stated that "a director's obligation includes a duty to attempt in good faith to assure that corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so . . . may . . . render a director liable for losses caused by non-compliance with applicable legal standards." *Caremark* at 970. The court noted that in the modern business world, there are criminal and civil statutes that require companies to have compliance programs in place in order to avoid or mitigate liability. While the court acknowledged that a board cannot know or be expected to know everything that goes on in a company, it concluded that directors must in good faith reasonably believe that the "corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibilities." *Caremark* at 970. Bottom line, in fulfilling its oversight duties, a board faces personal liability for failing to formulate and enforce internal systems for detecting and addressing corporate misconduct.

In contrast to the *Caremark* case, the Securities and Exchange Commission ("SEC") issued releases regarding *In re W.R. Grace & Co.*, Securities Exchange Act Release No. 39156 and 39157 (September 30, 1997) in which the Commission appeared to indicate that directors may not rely on a corporation's internal procedures for the preparation of disclosure documents filed with the SEC. Furthermore, the Commission indicated that outside directors have the same level of responsibility as insiders for a company's public disclosures. On its face, the Commission's ruling seems to undermine the *Caremark* decision by imposing on the directors personal responsibility for the accuracy of disclosure documents and not allowing directors to delegate that responsibility to legal counsel, accountants and management. While most commentators hold the view that the *W.R. Grace* should be weighed in light of its unusual facts (the undisclosed facts were known by the directors), directors must still approach public

disclosures very seriously. Probing questions by directors of management and legal counsel on the way they prepare disclosure documents should at least be the minimum in the case of disclosures relating to specific actions taken by a board (e.g., approval of a merger).

Issues for the Boardroom. Meanwhile back in the boardroom, how do directors conduct themselves in light of the *Caremark* and *W.R. Grace* cases? How much oversight can a board delegate? How much "hands-on" involvement in company operations is required of the directors? The SEC and the courts have made it clear that directors must take their duty of care seriously in overseeing the conduct of their companies. Certainly, a board should not delegate duties to management or others in a manner that would substantially interfere with its ability to exercise independent judgment in managing the corporation. They expect directors to take an active role in becoming informed about the business dealings and operations of their companies. Directors have a duty to inquire about the conduct of employees and to put adequate compliance programs in place for their particular company taking into account the nature of its operations, regulatory obligations, etc. The position taken by a board should be designed to send a message to everyone in the corporation that unlawful conduct will not be condoned and that, if engaged in, the responsible parties will be dealt with appropriate consequences. In adopting appropriate compliance programs, directors will need to be informed about business operations, regulatory requirements, etc. Appropriate compliance manuals, internal review and control procedures for matters like contract approvals, compliance training programs for employees and methods for reporting wrongful conduct should be adopted by the board under the *Caremark* decision.

3.2.4 Approving Actions To Deal With A Corporate Crisis. Open *The Wall Street Journal* on any morning and you will probably see more than one story about a company that is dealing with a major crisis. These crises include such problems as restating financial statements, internal fraud, the misappropriation of corporate funds, announcement of a defective product, the loss of a significant lawsuit or even a sexual harassment problem involving a corporate executive. What do directors do when they learn of these problems? How do they confront crises that insulate them from subsequent legal challenges? Is there a conflict of interest? What do the directors do to satisfy the duty of care? How do they protect attorney client privilege? What is the board's duty when it comes to their attention that may be corporate wrong doing? When is an internal investigation required? How should it be conducted? What should be its scope? Who should conduct it? These are just a few of the issues that a board is likely to face when a crisis arises. Of course, in dealing with a crisis, the board must comply with the duty of care in relying on the protection of the business judgment rule. Likewise, public disclosures will require compliance with federal securities laws and the requirements of other regulatory agencies to which the company is subject.

Issues for the Boardroom. When a corporate crisis comes, a board and its management team must address a myriad of critical issues and often, under very demanding time pressures. Since most companies operate under the belief that sooner or later a crisis will come, many boards put in place a standing crisis management team so that they can have the right people in place to address the matter properly and in a timely manner.

When initial information about a problem initially surfaces, the first issue for a board is almost always whether an immediate public disclosure is required or whether a thorough investigation should first be conducted. In seeking to satisfy their fiduciary duties, the question must ask: "Does the board have sufficient and reliable information to confidently make an informed judgment about the scope and magnitude of the problem and about whether and when any disclosure should be made?" Of course, that question will lead to a series of other questions. Who will be the spokesperson to the media? Will a preliminary disclosure possibly result in misleading statements? Will there be a safe harbor for making forward looking statements? Are the directors, management team and their advisors sensitive to the duty to correct and the duty to update prior disclosures? When do you bring in the outside auditors? How a board deals with these issues may be subsequently scrutinized by the courts.

The above kinds of issues can make the handling of a crisis a very stressful and a risky task for a board. For that reason, it is important for a board to stay focused on its duty of making fully informed decisions. Accordingly, as best as it can, a board must methodically work through a crisis with guidance from legal counsel and other advisors. It is very important in a crisis situation to keep a record of the information that the board has at the time of each of its decisions and its rationale for each decision because if later challenged, the board needs to be in the best position to demonstrate that under the circumstances at the time, it exercised due care in making its decision.

3.2.5 Approving Disclosures To Stockholders. In addition to disclosure duties imposed under federal and state securities laws, the Delaware courts have recognized that directors also have a duty to make full disclosure of all material information when stockholder approval of a transaction is required and when a board elects to obtain stockholder approval. See *Arnold v. Society for Savs. Bancorp Inc.*, 650 A.2d 1270, 1277 (Del. 1994). The Delaware courts have adopted the "materiality" standard of the federal securities laws. *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985). Additionally, whenever a board disseminates information to stockholders (even though no stockholder action is being solicited), the duty of disclosure is also triggered. See *Malone v. Brincat*, 722 A.2d 5 (Del. 1998). In these circumstances "the fiduciary duties of care, loyalty and good faith apply. Dissemination of false information could

violate one or more of these duties." 722 A.2d at 12. In that connection, some lawyers have suggested that the fiduciary duty of disclosure may be broader than the duty to disclose "material" information under federal securities laws.

Issues for the Boardroom. What is material information? What decisions by the board itself constitute material information? These kinds of questions must be addressed by the board in dealing with the duty of disclosure. For that reason, directors must take special personal responsibility for those disclosures that describe board decisions and intent.

## 4. ROLE OF COUNSEL IN PROTECTING DIRECTOR CONDUCT IN THE BOARD ROOM.

4.1 Overview. The importance of and need for ensuring and preserving the integrity of a board's business decision will obviously vary from situation to situation. A board's declaration of a quarterly dividend consistent with the corporation's historical dividend practice is one thing: spinning off a significant part of the corporation's business by way of a dividend is another. The care and attention that counsel will need to spend on a board meeting -- before, during and after -- will depend on the importance and complexity (business, legal, regulatory, political, public relations) of the decision. At the end of the day, counsel is just that: it is not his or her business decision to make. However, experienced counsel can help shape and guide a board's decision-making to achieve the best decision under the circumstances and preserve the record of that decision.

4.1.1 Information And Its Costs -- Third Party Transactions In A Less Than Perfect World. In a perfect world, every board faced with a difficult decision would have ample time to consider and explore all alternatives so that its decision is the product of an absolutely fully informed process. Few decisions achieve this level of perfection, however, particularly in the third party transaction context. Third parties with which the corporation is dealing will demand terms that foreclose the board's ability to inform itself -- they impose deadlines or they require periods of exclusive negotiations. One helpful principle counsel should have in mind in these situations is that the courts have recognized that information is not costless, and that a decision to seek or refrain from seeking additional information is as much a business decision as whether to expand a factory or use red instead purple widgets. Thus, in *In re RJR Nabisco, Inc.*, C.A. No. 10389, Allen, C. (Del. Ch. Jan.31, 1989), Chancellor Allen responded to plaintiffs' claims that the special committee of RJR's board had been negligent when it decided to end an auction for RJR rather than seek further bids:

> There is a compelling answer to [plaintiffs'] position. It is premised upon the insight, upon the fact, that information has costs . . . It concludes that the amount of information that is prudent to have before a decision is made is itself a business judgment of the very type that courts are institutionally poorly equipped to make.
>
> [T]he risks (costs) associated with getting more information had to be weighed by the Committee against the likely benefits.

Of course, a well planned decision-making process should anticipate demands that will seek to limit the board's ability to gather information and result in the board having sufficient information to make a decision with respect to the demands.

4.1.2 Interested Party Transactions -- The Importance of Process. Unlike a third party transaction, in which the business judgment rule presumption of regularity will apply, in a transaction between the corporation and a director or stockholder, the fairness standard may apply. Under this standard, a court will examine both the substantive business result and the process by which that result was attained to determine whether the process and result were fair to the corporation. See D. Drexler, L. Black & A. Sparks Delaware Corporation Law and Practice § 15.05[3], pp 15-2 - 15-23 (1999). Interestingly, it is often easier for a board (or committee) considering an interested transaction to insist that it have more time to consider the proposal than it would in a third-party transaction. That is, given the rigors of the fairness standard, the interested director or stockholder is often not willing to impose strict deadlines or other terms that can limit the time a board or committee has to consider the interested transaction.

4.2 The Board Meeting.

4.2.1 When Do You Need A Board Meeting? When Should You Have A Board Meeting? The relevant statutes, charter provisions and bylaws will dictate when you will need board action. For instance, merger agreements and charter amendments require board approval (8 Del. C. §§ 242, 251), and bylaws will sometimes permit a specified number of directors to call a special board meeting.

Prudence dictates other circumstances in which a board meeting should be held. For instance, if counsel can anticipate that a difficult board decision will have to be made at some unspecified time in the future, it can be helpful to hold a meeting prior to the decision date at which meeting the issues and considerations for the board are aired and

"teed up". When the decision point comes, the board will be able to deliberate with the benefit of the prior meeting.

The policy of most jurisdictions, including Delaware, with respect to the functioning of a board is collegiality: boards should act only after the directors have had an "opportunity for [the] exchange of ideas and discussion." Drexler, Black & Sparks, Delaware Corporation Law and Practice, § 13.01[6], pp 13-8 - 13-9. This policy is the basis for the requirement that the directors be given notice of meetings. It also presents one way to analyze whether directors should meet and invites the question "Is this matter sufficiently important that the directors ought fairly to have the chance to discuss it together?"

4.2.2 Wishful Thinking -- Polling Directors As The Substitute For A Meeting. Management will sometimes resist calling a meeting to discuss a particular matter, sometimes out of concern over "bothering" the board, sometimes for other reasons. As an alternative, "polling" the board, that is having individual discussions with each board member on a particular topic, will be suggested. Polling is certainly an appropriate way to sound out individual board members or to keep directors updated. It is not, however, a substitute for a meeting or an effective means for the board to act. *Liberis v. Europa Cruises Corporation*, C.A. No. 13103, Balick, V.C. (Del. Ch. Feb. 8, 1996); *Curtis v. Pipelite Corp.*, 370 SW2d 764 (TX 1963).

4.3 Planning For The Board Meeting.

4.3.1 Overview. One of the best ways to deal with a difficult board meeting is not to have a difficult board meeting in the first place. Advance planning, a thoughtful analysis of the issues to be considered and liberal doses of common sense can help avoid many of the circumstances that can make for a difficult meeting in the first place.

4.3.2 Working With Management (And Other Advisors) In Preparing For A Board Meeting If the importance of a particular board meeting warrants counsel's involvement, careful planning of the meeting is not only appropriate but necessary. Counsel should fully understand the issues to be considered not only from a legal standpoint but from a business standpoint as well. Begin with management: What's their perspective on the issue? What would they want to see if they were board members? How can information relevant to an issue best be synthesized without losing focus? Is the involvement of other advisors appropriate or important to the board?

Counsel or management should consider sounding out directors about particular concerns that can or should be addressed in advance. Although, as noted above, polling

is not a substitute for a meeting, one-on-one conversations with directors can elicit the particular concerns of directors and identify issues that they would like addressed.

4.3.3 Advanced Notice Of The Meetings; The Board "Package". At one level, giving proper notice of a director's meeting is straightforward and easy. The corporation's bylaws (or sometimes its certificate of incorporation) will set forth the notice requirements. In some situations, the corporation may be tempted to have a meeting without notice to all directors. For instance, directors who have a financial interest in a transaction that is to be discussed at a meeting may not be given notice because of that interest. This is almost always a mistake, as any action taken at the meeting is not effective. See Drexler, Black & Sparks, Delaware Corporation Law and Practice, § 13.01[6], pp 13-8 - 13-9. Sometimes, concerns over privilege issues will lead to the same strategy. Courts are generally not sympathetic to this rationale. See *KLM v. Checci*, C.A. No. 14764-NC, Steel, V.C. (Del. Ch. July 23, 1997).

It is advisable in all situations to give formal notice of a special meeting, even if all the directors have earlier agreed to a meeting time. This will establish a clear record of notice.

Should a notice be given further in advance than required by the bylaws? If possible, yes. However, whether this is possible will often depend on the availability of other information that will be sent with the notice. The more involved the information, in general, the longer the time documents should be in the hands of directors in advance of the meeting.

In addition to the notice of the meeting, what other materials should directors get? In general, as much helpful information as possible. Timing and practical considerations obviously will play a role. However, drafts of documents under negotiation are better than no documents at all. A summary of the principle terms of important documents (similar to a term sheet), and a brief discussion of "open" issues can be useful. Materials prepared by advisors and experts should be distributed, too, such as banker presentation "books", drafts of legal opinions or fairness opinions, reports from compensation consultants and reports from other experts on technical issues as needed. Finally, a set of the resolutions that the board will be asked to consider can be helpful.

Counsel should try to review all of the materials that are sent to the board before they are sent. This includes banker presentation materials and the reports of other experts. This can help reduce the likelihood of the board receiving contradictory or inconsistent advice from its advisors.

4.3.4 The Meeting Agenda. The board package may also include an agenda for the meeting. Bylaws will sometimes address who sets the agenda for the meeting, although typically it will be established by management and the chair of the meeting. In special circumstances, it might be established by other directors. For instance, if a group of directors call a special meeting of the board, those directors will set the agenda.

4.4 Conduct Of The Meeting.

4.4.1 Overview. Two of the interrelated principles discussed above should be the keystones to the meeting: care and collegiality. The purpose of the events leading up to the meeting and the meeting itself is to give the directors sufficient information to make a good business decision. With this information before them, the directors should be able to exchange views, ideas and perspectives openly and deliberately. The conduct of the meeting can affect both.

4.4.2 Chairing The Meeting. The identity of the chair of the board meeting will most often be addressed in the corporation's bylaws, which will authorize a particular officer -- typically the chairman of the board, the president or the chief executive officer -- to chair the board meeting. In the absence of a specific bylaw provision, the chair should be selected by the board.

The chair has an important role in facilitating the sharing of viewpoints and achieving consensus. There is no right or wrong way to chair a meeting and much will depend on the character of (and the characters on) the board, the size of the board and each individual board member's experience with similar situations.

In general, the chair should refer to the agenda as a guide while, at the same time, being sensitive to the occasional need to depart from the agenda as the board discussion seems to dictate. The chair should seek as much as possible to be "above the fray" and as outwardly impartial and nonpartisan as possible. A strong show of position by the chair, at least early in the meeting, can discourage open discussion.

4.4.3 When Do You Need an "In-Person" Meeting? Delaware law and the laws of most other states permit directors to participate in a meeting by conference telephone call (subject to certain requirements, such as the board members being able to hear one another). As technologies evolve and corporate statutes respond, it will soon be possible to hold meetings by other electronic means, such as in chat rooms. Legally, these means of having a meeting are interchangeable. There is, however, no substitute for a face-to-face, in-person meeting. Gauging the body language and facial expressions of fellow director or changes in voice inflection can be as important to understanding what a director thinks about an issue as what the director says he thinks.

How hard should counsel push for an in-person meeting? In most cases, when there is a difficult or uncomfortable decision to make, it is very important. Obviously, you don't ask a director to leave her vacation in Nepal to attend a meeting, but it may be important enough to prevail upon a director to spend three hours on a plane to get to an in-person meeting. How hard to push for an in-person meeting will also depend on the board's history with the matter. For instance, counsel may feel less compelled to insist on an in-person meeting if a prior in-person meeting has been held at which the matter was discussed in detail. (See Section 4.2.1)

4.4.4 The Hurried Director. The almost necessary corollary of the prior section is the director who has to be somewhere, either now or shortly. How do you deal with the hurried director? First, you try to accommodate him or her. Can the meeting be moved up or back an hour? Can it be scheduled in a place more convenient for the director? Second, information for the meeting should be assembled with this particular director in mind. Have executive summaries been reduced to the essentials? Finally, you can ignore him (or his "hurriedness"); when it comes time for him to leave, he leaves. This is an important option because sometimes, the steps taken to accommodate the hurried director can impair the effective functioning of the rest of the board. Don't let this happen. Instead: consider letting the hurried director leave when she has to but continue the meeting (assuming, of course, you will continue to have a quorum). Or schedule a follow up meeting. (Note: directors cannot act by proxy. *Lippman v. Kehoe Stenographic Co.*, 95 A.895 (Del. Ch. 1915)).

4.4.5 Presentations To The Board. A typical structure for a meeting is to begin with an overview of the matters to be considered, which will orient the directors and provide a context for the meeting, followed by the presentations by management, advisors and experts, with discussions and questions by the directors next and finally the directors coming to a decision. The length and breadth of presentations will vary depending on many factors such as the board's sophistication and familiarity matters at hand (See Section 4.2.1), the quality of the materials sent to the directors in advance, the importance of having a record that the board received and considered the advice of an expert and other factors.

Presentations, particularly good ones, can enrich a board's decision-making. Don't shortchange presentations. Although the materials supplied to the directors in advance of the meeting are important, a good presenter can bring into focus important subtleties not apparent in even the best written presentation materials.

Section 141(e) of the Delaware General Corporation Law provides that directors are fully protected from liability if they rely "in good faith" on the opinions, reports or

statements of officers or board committees, or experts chosen by or on behalf of the corporation as to matters that the board member believes are within the expert's professional competence. In this context, good faith means that the director does not or should not, in the proper exercise of his or her office, know of facts that would lead him or her to believe that the report is inaccurate, incomplete or flawed.

Care should be taken over who is in the board meeting when. It is not unusual to have counsel in attendance throughout the meeting. However, to preserve the attorney/client privilege of counsel's advice, consider who should be in the meeting room when the advice of counsel is received.

It will almost always be important for counsel to spend some time reviewing the contents of documents that the board is to consider. How much time and in what detail will depend on such factors as how long the directors have had the documents, how familiar the directors are with the document being reviewed, and the extent of the changes to the documents from the last draft distributed to the directors. In most circumstances, it is good practice to review the highlights of the documents and any business issues presented by the then current drafts of the documents (*e.g.*, significant disclosure and due diligence issues, regulatory approvals, timing, critical dates, etc.).

4.4.6 <u>Taking and Recording The Vote</u>. Once the discussion has concluded and all questions have been answered, the chair may ask the board to vote on the question before it. If the board has been provided an advanced copy of the resolutions to be adopted, these resolutions (and any agreed upon changes to them) can be considered and voted upon.

The vote of particular directors or groups of directors can be important and special care should be taken in these situations. The precise vote of the directors can also impact the stockholder vote required to approve the transaction under applicable statutory, charter and bylaw provisions. See e.g., *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1987). The presence or absence of interested directors (together with a disclosure of their interests) should be noted. See 8 <u>Del.</u> <u>C.</u> § 144. The vote of outside directors can affect the substantive standard of review that might apply in a stockholder challenge to the action. For all these reasons, and to avoid any uncertainty over the vote in these types of situations, a role call vote is preferable.

4.4.7 <u>Completing The Unfinished Details. How Much Leeway Can Or Should Be Delegated</u>. No process is perfect. Documents to be presented to the board can't always be finalized in time for the meeting. What should be done?

There is always a temptation to delegate to management the authority to make "such additional changes as the proper officers, in their sole and absolute discretion, determine to be necessary." Use this approach with caution, however. First, some statutes require the board to approve "the agreement" or "the amendments". See 8 Del. C. § 242, 251. Although making changes for typos may be acceptable, ask whether, in light of statutory language, changes should be made that the board has not approved, even if they are "non-substantive changes." (If they are "non-substantive," why are they being made?). Strategies for dealing with post meeting changes include: establishing a committee of the board to approve the final documents (Note: that this is not an option for all situations. See 8 Del. C. § 141(c)); circulating a consent approval the final documents; or having a short meeting to approve the execution copy of the documents when they are ready.

4.5 Special Director Demands.

4.5.1 Demands For More Information. Section 220(d) of the Delaware General Corporation Law provides that a director has the right to examine the corporation's books and records "for a purpose reasonably related to the director's position as a director." Given this statutory right, and the goal of having directors to be as fully informed as possible under the circumstances, why would a corporation even consider denying a director's request for additional information?

First, implicit in the statute is a recognition that there may be circumstances in which the director's request is not appropriate. There may be circumstances in which the information requested is not "reasonably related" to the director's position.

Second, the statute permits the court to "prescribe any limitations or conditions with reference to the inspection" as the court may "deem just and proper." Thus, even if the director has a proper purpose, the statute recognizes that there may be circumstances in which it is proper to "limit or condition" the director's access to information.

Notwithstanding these nice arguments, in practice, the courts have been very reluctant to deny a director's request for information and the authors of this outline are not aware of any Delaware case in which directors have been denied access to corporate information. This is because the director's right to inspect books and records is "correlative with his duty to protect and preserve the corporation. He is a fiduciary and in order to meet his obligation as such, he must have access to books and records; indeed he often has a duty to consult them." *Henshaw v. American Cement Corp.*, 252 A.2d 125, 128 (Del. Ch. 1969). In *Henshaw*, the court rejected the corporation's contention that the directors admitted conflict of interest was a sufficient basis to deny him access to the

records he sought. Concerns over the director's possible misuse of the information were addressed by the fact that the director, as a fiduciary to the corporation, was obligated not to use or disclose any information to the detriment of the Corporation and the consequent threat of liability if he breached that obligation. *Id.* at 129. See also, *Belloise v. Health Mgmt.*, 1999 Del. Ch. LEXIS 127 (June 11, 1996) (transcript of oral ruling); *Holdgreiwe v. Nostalgia Network, Inc.*, C.A. No. 12914, Allen, Ch. (Del. Ch. April 29, 1993).

4.5.2 Demanding the Presence of a Director's Personal Advisor. On occasion, a director may seek to have her own advisors--lawyers, investment bankers, accountants, soothsayers--attend a meeting. The authorities are split on the question of whether she has a right as a director to have those advisors attend the meeting. *Fletcher Cyc. Corp.*, § 418 (Perm. Ed.). The better view appears to be that the board has the authority to invite to or exclude from the meeting who it wishes. At a practical level, one can understand how a contrary result could lead to unwieldy meetings.

If a director is insistent on bringing her own advisors, what should a board do? Importantly, it should recognize that if the director's requests is denied, the director has an alternative: she can keep her advisors close by the meeting room and, throughout the meeting, state for the record: "Mr. Chair, I have heard a great deal of involved, complicated information. To satisfy my duty of care and to fully understand this matter, I need to consult with my advisors. Can we take a short recess?" Although a board could well be skeptical about such a statement, it would be hard-pressed to resist it. Thus, the decision faced by the board is which sort of disruption does it wish to deal with: the disruption of having the director's advisors in the meeting room or the disruption of periodic adjournments to permit the director to consult with her advisors.

4.5.3 Demand That a Personal Statement Be Included In The Minutes. A director may feel so strongly about a position, particularly if it is at odds with the position of a majority of the directors, that she may demand that a statement in support of her position be included in the minutes. Although there is little case law, it appears that a director has no such right, particularly when a majority of the directors act to disapprove of the inclusion of the statement.

The board's decision to exclude a personal statement from the minutes could be on the basis that the statement is so offensive or scurrilous that it would be inappropriate to include it in the official minutes of the meeting. However, if the motivation for excluding the statement is a desire to suppress or not acknowledge the dissenting director's position, counsel should consider the dissenting director's alternatives. For instance, the dissenting director can bombard the board members, corporate secretary, other officers and others (the press) with correspondence stating the director's position. If counsel fears a record, this correspondence will surely create one.

Section 174 of the Delaware General Corporation Law, dealing with the liability of directors for unlawful dividends and stock repurchases, addresses this issue in that context. Subsection (a) of Section 174 provides that:

> Any director who may have been absent [when an unlawful distribution was approved], or who may have dissented from the act or resolution by which the same was done, may be exonerated from liability [for the illegal distribution] by causing his or her dissent to be entered on the books containing the minutes of the proceedings of the directors at such time the same was done, or immediately after such director has notice of the same.

This provision suggests that a director may have a right to have his "dissent" recorded. Does the "dissent" include the director's statement in opposition to the action taken? Probably not. See *Brewer and Solberg, "Corporate Minutes: What Should They Include?"* 20 Bus. Law 745, 748-9 (1965).

4.5.4 Demand Of Interested Director To Be Present During Deliberations Over the Interested Transaction. As noted above, there can be a temptation not notify an interested director of a meeting at which the subject of the director's interest is to be discussed by the independent directors for the very reason that the interested director may come to the meeting. Most often, the interested director can be persuaded that, notwithstanding notice of the meeting, she should absent herself from the meeting or the portions of it at which the interested transaction will be discussed. What should be done if efforts to persuade her are unavailing?

In this circumstance, the board and its counsel need to assess whether the presence of the interested director will inhibit the free exchange of the directors' viewpoints and perspectives. If the presence of the interested director will not have this effect, and there is no other reason to seek to exclude the director then, notwithstanding the untoward appearance of the presence of the director, the meeting can proceed. If, however, it is determined that the interested director's presence will inhibit free discussion, the board can consider appointing the disinterested directors as a committee of the board and having that committee meet to discuss the matter without the interested director. Although the interested director may ultimately be able to obtain access to the books and records of the corporation relating to the meeting of the special committee, such as minutes, the minutes will be written in such a way that sensitive information is not divulged.

4.5.5 Demand to Speak To Company Counsel Alone For Advice. In some circumstances, legal counsel for the corporation may be contacted directly by an individual director or a group of board members seeking legal advice regarding matters involving the board and/or the corporation. Normally, counsel should be responsive to these requests. However, corporate counsel should first make a careful analysis of the nature of the inquiry to determine if a potential conflict between directors, between directors and management or between the directors and the corporation may exist. In the absence of that analysis, legal counsel can unknowingly find himself or herself caught in the middle of a board fight. In those situations, the lawyer may inadvertently conflict himself or herself or at least, lose credibility with some or all of the board.

4.6 Proper Recording Of Actions Taken In A Board Meeting.

4.6.1 Overview. The preparation and approval of the minutes of board meetings must not be taken lightly by directors or their legal counsel. The content of board minutes can often be pivotal evidence in litigation challenging director conduct. Since conduct within the boardroom is supposed to be recorded in the minutes of the meeting, plaintiffs will carefully pour through them looking for deficiencies. On the other hand, when properly prepared, board minutes can effectively demonstrate that directors carried out their fiduciary duties. Board minutes are going to be given a presumption of credibility even though their correctness may be rebutted in a courtroom by other evidence. *Sykes v. Caldwell*, 282 SW 282 (TX Civ. 1926); *Young v. Janas*, 103 A.2d 299, 303 (Del. Ch. 1954).

4.6.2 Board Minutes Requirements. A company that does not keep minutes will begin from a position of distinct disadvantage in any litigation. As for Texas, Article 2.44A of the Texas Business Corporation Act requires that minutes ("in written form or in any other form capable of being converted into written form within a reasonable time.") be kept of board meetings. The Delaware General Corporation Law does not have an analog to the Texas statute. However, Section 142 requires that each Delaware corporation have an officer who has "the duty to record the proceedings of the meetings of the stockholders and directors in a book to be kept for that purpose." However, Article 2.44A, Delaware law and case law are silent as to what should be the content and scope of minutes. Accordingly, the drafter and the board of directors in approving minutes have great latitude in deciding their scope and content. Still, board minutes are subject to the statutory inspection rights of directors and stockholders. See Article 2.44C of the Texas Business Corporation Act and §220 of the Delaware General Corporation Law. Of course, board minutes are always subject to being subpoenaed in litigation involving alleged director conduct. Board minutes should always be prepared on the basis that they will be scrutinized later by third parties and that their content may be determinative in subsequent litigation.

4.6.3 Preparation of Board Minutes. Board minutes should be prepared with the primary objective of showing that the directors took the steps needed to fulfill the applicable fiduciary duties and standards of judicial review discussed in Section 3 above. Of course, board minutes must accurately reflect board action and avoid the potential for ambiguity in what occurred in the boardroom. For instance, with respect to duty of care, the drafter must prepare the board meeting minutes with the objective of showing: (i) that the directors fully informed themselves before acting, (ii) that the directors asked appropriate questions with a healthy amount of skepticism and, (iii) that directors spent the time needed to deliberate and decide the issue. In particular, some of the following items would most likely be reflected in the minutes:

(i) Persons present at the meeting and whether in person or by teleconference.

(ii) Information that was sent to directors in advance of meeting on major corporate matters.

(iii) Highlights of the presentations to directors by management, experts (*e.g.*, investment bankers, legal counsel) and other third parties.

(iv) Highlights of key substantive questions asked by the directors of management, experts and other, and the nature of their responses.

(v) Highlights of the deliberation among the directors including any specific debate.

(vi) Results of the vote taken.

Generally speaking, to defend against second-guessing after the fact, it is advisable, especially in the case of difficult decisions where the facts are fluid and subject to change, for the board minutes to reflect (1) the key facts as the board understood them at the time of its decisions and (2) the key rationale behind the board's decisions in the context of those facts.

Finally, the actual corporate resolutions adopted by the board should be clearly set forth in the minutes. It is common practice with respect to major matters that the corporate resolutions be presented to the board in draft form at the meeting in which a decision is to be made by the board. In this regard, it should be remembered that the

protection afforded to directors by the business judgment rule applies only (i) to actions taken by a board and (ii) to a board's conscious decision to refrain from acting. See *Aronson v. Lewis*, 478 A.2d 809, 813 (Del. 1984); *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). Thus, if board minutes fail to adequately spell out a board's decision, the directors are likely to have difficulty in proving that they made a decision which entitles them to the protection of the business judgment rule.

4.6.4 Detail and Length. There is always the question of how long and how detailed should the board minutes be. Much depends on the specific circumstances. Many actions by boards will fall clearly within the perfunctory category and thus, they generally do not need the attention given to them that would be appropriate for a major business transaction. However, drafters of board minutes should always be cautioned to keep the form of minutes consistent otherwise, the drafter will be subject to attack as to major inconsistencies.

4.6.5 Note Taking By Directors. Most companies have a policy about note taking by directors. Because of the ambiguity and incompleteness of personal notes, directors are encouraged to destroy them once the minutes of a meeting are approved by the board. Thereafter, the board minutes should be the sole record of what occurred at the board meeting. Of course, if a director disagrees with what is in the minutes, that person will be expected to keep his notes. The final form minutes will be what the majority of directors correctly reflects what occurred. The board minutes approving the disputed minutes of the prior meeting will reflect the dissenters' disagreement.

## 5. CONCLUSION.