

17 Steps to Minimize Your Directors' Personal Liability Risk

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1. **Ensure Your Directors Have More Than Adequate D&O Liability Coverage.**
 - Both dollar amount coverage and substantive coverage (beware the exclusions).
 - This requires expert advice – don't do it on your own (unless you are an expert).
 - Lots of traps for the unwary – The “market” is ever changing – lots at risk.
 - Beware the *application*.
 - Explore supplemental Side A coverage -- your directors will like it (and you). Plus, personal umbrella policy coverage.
 - Explore whether your D&O insurance covers legal costs in response to SEC investigations (whether informal or not) and internal investigations.
 - Make sure that, if you are *General Counsel*, you are also covered (it may not be so clear).
2. **Ensure the You Have State-of-the-Art Corporate Indemnification Provisions.**
 - Explore expanded bylaws or individual agreements (there are lots of ways to enhance coverage, both substantively and procedurally).
 - Wisconsin has very expansive statutory protections.
3. **Ensure that Your Director Liability Shields Are in Place.**
 - If you are incorporated in Wisconsin, the mandatory shield is automatic.
 - If you are incorporated in Delaware, you must opt-in and also define “good faith.”
4. **Ensure Your Directors Satisfy Their Duty of Care.**
 - Biggest and most important step – one that you can ensure is satisfied.
 - Agenda setting – involve more than just your CEO/Chairman/Lead Director.

- Provide advance information to your Board on all important agenda topics, including (1) appropriate summaries; (2) financial analysis; (3) pros and cons analysis; (4) comparison to “market” terms; (5) copies of actual material contracts; (6) alternatives available; and (7) when appropriate, expert reports / advice.
- Ensure key topics are described well at the meeting and actually deliberated on by your board. You need to encourage and/or self-initiate inquiries and debate [*you should make sure all of the “right” questions are asked and that satisfactory answers are provided*].
- Might require establishing new “rules of engagement” for your Board [Chairman/Lead Director].
- Ensure that adequate time is spent covering important issues, since the amount of time spent is often a prima facie proxy for “good corporate governance” (may require multiple meetings for important decisions).
- Encourage your Board/Committees to hire independent experts, advisors or consultants who report directly to the Board/Committee.
- Ensure the expert’s work product and advice are delivered directly to Board/Committee (not edited or pre-reviewed by management).
- Ensure the expert is present at the relevant board meeting.
- Ensure that there is effective follow-up on open issues, board requests, supporting advice – never leave open unanswered questions/requests for information, etc.
- Make sure your Board and Committees comply with their charters and governance guidelines. Don’t create your own roadmap for a governance failure.
- Use consent actions sparingly – important matters require debate and in person (by phone) meeting.
- Make sure your Board is made aware of media reports/analyst reports about the company/officers/problems.
- All of the above are especially important for the high-risk areas of (1) executive compensation; (2) executive severance; (3) parachutes; (4) related party transactions; (5) conflict situations; (6) anti-takeover provisions; and (7) M&A activities.

5. **Ensure Your Directors Satisfy Their Duty of Loyalty.**

- Revisit and refine your Board’s independence criteria. “True” independence is becoming increasingly more important to courts [in most bad liability situations, directors were beholden to management]. Has created many bad precedents.

- Conflicting obligations of directors (other boards, full-time jobs, etc.) are being used increasingly by plaintiffs as a proxy for bad corporate governance.
- Full disclosure/scrutiny of all conflict of interest situations, approved by disinterested directors after full financial analysis; compare to terms provided to/by non-interested persons.
- Ensure that your corporate code of conduct is actively enacted, enforced and overseen and that a strong positive tone from the top is established. Make sure your code is not just a piece of paper sitting on your shelf.
- Ensure that you have implemented an effective and well-communicated anonymous whistle-blower process – and that the “results” are reported to the Board. *Is it working?* – Are you getting complaints? Even bogus ones? Be aware of the additional incentives for whistleblowers under Dodd-Frank which provide for awards of up to 30% of your sanctions if you’ve violated federal securities laws.

6. Document Well Your Board’s Compliance with its Duties.

- *Well prepared and detailed minutes are now a must. The “old school way” is no longer prudent. Avoid Disney problems.*
- *Minutes should reflect: (1) advance info provided; (2) topics discussed; (3) reports given; (4) active deliberations and general nature of debate (without specifics or individual attribution); (5) thorough Q&A sessions (without specifics or individual attribution); (6) expert advice given; (7) directives provided; and (8) resolutions adopted.*
- *Reflect both substance and process. Process is equally as important.*
- *Get draft minutes out within two weeks for comment by all directors.*
- *Think of how you’ll draft your minutes when you send out the advance Board books and conduct the meeting (and act) accordingly.*
- *How will your minutes look if “exposed” in the media or court?*

7. Ensure Effective Disclosure Committee Processes are Undertaken for Public Company Earnings Releases and SEC Filings.

- *Public disclosures and filings should be well vetted in advance of filing by a broad group of senior/hands-on people. Avoid “last minute” rushes.*
- *Spend lots of time on the risk factors in your 10-K. Plain English/transparency. Cross-check with ERM issues raised with senior management and Board.*

- *Miranda* warning → Be specific and extensive (take advantage of the safe harbor).
8. **Shareholder/Market Communications.**
- *Take into account and consider institutional shareholder demands/requests. Don't "ignore" them.*
 - *Make sure you are Reg FD compliant/understand the do's/don'ts.*
 - *Avoid selective disclosure of material, undisclosed information.*
9. **Revisit and Enhance Your Insider Trading Prohibition Policies.**
- *Make sure that your insider trading prohibitions are well understood and communicated to all directors/officers – and revisit annually.*
 - *Insider stock sales almost always exacerbate Board/corporate liability resulting from other bad news or bad acts.*
10. **Create an Emergency Response Plan.**
- How would your company react to a *BP*-type situation?
11. **Update Your Executive/Board Succession Plan.**
- McDonald's issues – 2 CEOs died in rapid succession – Is your Board prepared?
 - Disney issues – "imperial" CEO with passive board.
 - Board selection criteria should be enhanced.
12. **Revisit and Enhance Your Corporate Governance Policies and Committee Charters.**
- Make sure you are actually complying with these documents.
 - Dodd-Frank: directing securities exchanges to establish new requirements for compensation committees.
13. **Know What Your Board Needs to Approve**
- Avoid *Disney* confusion – it was not perfectly clear that the CEO had the right to unilaterally fire his President.
14. **Board/Director Evaluation Process.**
- An effective evaluation process is very helpful to enhancing value-added Board governance.

15. **Take Extra Care With Executive Compensation Decisions (Dodd-Frank)**
 - Say on Pay and Say on Golden Parachutes may lead to increased litigation against boards.
 - Directors may be forced to pursue clawbacks against executives in the event of financial restatements.
 - Delaware courts have suggested there is an upper limit as to what they will allow for executive compensation, even if that limit is still undefined.
16. **Adopt and Implement An Effective Director Document Retention Policy**
 - Only retain final minutes of Board meetings and official Board book materials.
17. **Advisory Boards Don't "Protect" You**
 - Avoid the false impression that "advisory boards" don't carry the same liability risk as "real" boards.