30-SECOND SUMMARY Once grounds for investigating a board member have been identified, it is important to task outside counsel with the job of conducting a full and independent investigation. This will not only help give counsel's ultimate investigative findings additional credibility with company stakeholders, but will also be a factor considered if and when the authorities step in. The easiest way to ensure board member cooperation in an internal investigation is to explicitly include a duty to cooperate in board member service agreements. If you do not have clear service agreement language in place, or a board member accused of alleged misconduct refuses to cooperate, keep in mind that board members owe a fiduciary duty to their companies. It may be necessary to remind a recalcitrant board member of his duties of care and loyalty.

INVESTIGATING ALLEGED Board Member Misconduct

By Sean Radcliffe and T. Markus Funk

Let us start our discussion with an area of broad consensus: A company's board of directors has a duty of care to respond to and investigate allegations of wrongdoing by officers and employees of the company. But what happens when the board member is the one in the investigatory hot seat? Do the same investigative rules and techniques apply when, for instance, a director has been accused of trading on insider information or leaking confidential information? And what are the best practices companies should consider proactively implementing so they are best-positioned to effectively investigate alleged board member misconduct? We will try to provide some time-tested, common-sense — but often overlooked — guidance to help you prepare for these not-so-uncommon eventualities.

The basics: Hire outside counsel carefully, task specifically

Once grounds justifying an investigation have been identified, the company (typically through a special committee of the board) should clearly define the investigatory objectives so as to avoid any ambiguity concerning what is within the outside investigators' charter. Companies are also well advised to retain experienced and independent outside counsel; being able to demonstrate little prior involvement with the company or board members can be a plus in this regard. Tasking outside counsel with the job of conducting a full and independent investigation will not only help give counsel's ultimate investigative findings additional credibility with company stakeholders, but will also be a factor considered if and when the authorities step in and review the investigative findings.

It will be natural for the company's management and board to have misgivings about unleashing independent counsel on an investigation. Those concerns can be partially addressed through advance planning and proper oversight (again, most likely by a special committee of the board). Nevertheless, everyone involved must be prepared in advance for the reality that an allegation involving a director must be addressed with complete objectivity. It is not the time to succumb to fear or concern about perception. As with any investigation where the stakes are high, start by assuming nothing, let experienced investigators follow the facts, and then address the implications of what has been found.

The first step to securing board member cooperation: Service agreements

If they address the topic at all, companies may include in the corporate governance guidelines a statement that board members are expected to cooperate with investigations. However, the surest way to ensure board member cooperation in an internal investigation is to explicitly include a duty to cooperate in a service agreement with each board member (consider in this vein the employee's duty to cooperate in an employment contract or handbook).[1] The agreement should include simple, direct language requiring a director to fully cooperate in any internal or external investigation, and should specify that cooperation includes expeditiously turning over any requested documents and communications within the director's possession, custody or control, including personal phone records, email account information and so forth. Note that such a broad request may encounter resistance; therefore, companies must carefully tailor such language to their specific circumstances. The company may also want to specify that the duty to cooperate remains even after a director resigns, or is terminated, to the extent that the investigation involves conduct the director engaged in while he was a board member.[2]

As touched on previously, one drawback to including this language in the agreement is potential pushback from the prospective board member. This can be managed, in part, by including a reciprocal duty by the company to cooperate.[3] It might also help to explain, as part of a director training program, the benefit each director derives from indemnification, the business judgment rule, insurance and any other protections specific to the company. Thus, the company is not asking more from the board member than it is willing to provide.

Duty to cooperate

Clear service agreement language mandating cooperation is, of course, great, but what if you do not have it in place? To make matters worse, what do you do if a board member accused of somehow being involved in the alleged misconduct simply refuses to cooperate with the investigation?

In the face of such a refusal (which is, in fact, fairly common), it can be helpful to politely point out that board members owe a fiduciary duty to their companies, including a duty of care and a duty of loyalty.[4] These duties, in turn, include a duty to cooperate with an internal investigation[5] (note, however, that such a duty to cooperate is not explicit in the Model Business Corporation Act, nor is it settled as a matter of law).

The reasonable expectation of cooperation is animated by an understanding that officers and corporate directors like yourself have a fiduciary duty of care to respond to allegations of corporate wrongdoing by fully and independently investigating the accusations, and by considering all pertinent information bearing on the issue. Once a director or officer is put on notice regarding a claim of serious wrongdoing, he must put forth a reasonable effort to discover all relevant information to fulfill the duty of care, including, making himself available for reasonable

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questioning calculated to determine whether any wrongdoing occurred.[6]

This position is also reflected in Section 302 of SOX (codified at 15 U.S.C. § 7241), which imposes upon officers a responsibility to ensure that they have accurately reported to the company's auditors and to the company's audit committee any fraud, whether or not material, that involves directors, management or other employees who have a significant role in the issuer's internal controls. These provisions incentivize CEOs and CFOs to diligently investigate any known or suspected wrongdoing brought to their attention; a failure to do so may subject them to liability.

Board member resolutions

In the absence of a duty to cooperate in the service agreement, the board can also require cooperation from its directors and officers as part of its resolution authorizing the investigation.[7] The only downside to this course of action is that the board adopting the resolution is the same board subject to investigation, and thus, may not of its own accord, include the duty to cooperate. The lesson is that it is always preferable to include duty-to-cooperate language in the service agreement — before any allegations of misconduct arise.

Communication devices

Companies should also consider whether to issue communication devices to board members and require members to use these devices for company business. This requirement can be included in procedures adopted by the board, or in individual service agreements, and would give the independent investigators access to these communications in the event of an internal investigation. This requirement could also prevent the inadvertent waiver of privileged information. For instance, if a board member is not provided with an email account and is communicating with an attorney using a different company's email account (that is monitored by the other company), then there is the risk that the otherwise applicable attorney-client privilege for those communications may be deemed waived.[8] Conversely, if the board member fails to follow company instructions about using designated communication services or devices, then that may provide an independent ground for potential removal.

A muted word of caution: Although requiring the use of company-issued communication devices or email accounts may be helpful when investigating a recalcitrant board member, it also puts a greater burden on the company in the event of an external investigation.

A muted word of caution: Although requiring the use of company-issued communication devices or email accounts may be helpful when investigating a recalcitrant board member, it also puts a greater burden on the company in the event of an external investigation. Specifically, the company will be required to maintain and preserve the information and may be subject to sanctions if, for instance, it doesn't take steps to preserve text messages once litigation is reasonably anticipated.[9] Additionally, and as noted above, board members may reject any service agreement that allows the company unlimited access to their communications.

Contain the damage

Companies have a duty to investigate allegations of board member misconduct. In discharging that duty, companies should:

- Seek independent outside counsel to conduct investigations into credible allegations of wrongdoing.

ACC EXTRAS ON... Investigating board member misconduct

Top Ten
Top Ten Tips for Conducting Effective Internal Investigations (Nov. 2010).
www.acc.com/topten/internal-inves_nov10

Form & Policy
Sample Board Code of Conduct (Apr. 2011).
www.acc.com/form/cond_apr11

Survey
2010 Board of Directors and Compliance and Ethics Officer Relationship Survey (June 2012).
www.acc.com/survey/bod-ethics_jun12

Poll
Do You Conduct Background Checks on New Board of Director Recruits? (Dec. 2011).
www.acc.com/poll/bod-check_dec11

ACC HAS MORE MATERIAL ON THIS SUBJECT ON OUR WEBSITE. VISIT WWW.ACC.COM, WHERE YOU CAN BROWSE OUR RESOURCES BY PRACTICE AREA OR SEARCH BY KEYWORD.

- Proactively include a duty to cooperate with internal investigations in all board member service agreements.
- Absent appropriate language in the service agreements, include the duty to cooperate in any board resolution authorizing the investigation.
- Maintain confidentiality, move quickly to determine if there are any actions needed to protect the workforce, hold and preserve appropriate records, review relevant corporate policies, and provide the investigator with access to records and individuals.
- Consider requiring directors to use designated communication services or devices for all company business.

Business disruption and damage to employee morale due to inevitable infighting are common side effects, as are claims that the special committee is exceeding its authorization or otherwise engaging in a "witch hunt."

As those who have gone through investigations into allegations of board-member wrongdoing can attest, the process can be exceptionally costly, both financially and emotionally. Business disruption and damage to employee morale due to inevitable infighting are common side effects, as are claims that the special committee is exceeding its authorization or otherwise engaging in a "witch hunt." Nobody wants to be in the middle of this type of an internal investigation, but with a bit of foresight and preparation, the duration and toxicity of the experience can be contained, and the reliability of the resulting oral or written report can be dramatically enhanced. **ACC**

NOTES

1 This is also similar to insurance agreements that require the insured to cooperate in investigations. *See, e.g., Stewart Sleep Ctr., Inc. v. Atl. Mut. Ins. Co.,* 860 F. Supp. 1514, 1519 (M.D. Fla. 1993); *Liberty Mut. Ins. Co. v. Precisionaire, Inc.*, 8:00-CV-1971-T-17EAJ, 2006 WL 905389 (M.D. Fla. Apr. 7, 2006).

2 *Cf. Lindquist v. Linxian,* 11-23876-CIV, 2012 WL 3811800 (S.D. Fla. Sept. 4, 2012) (after resignation, board member had no fiduciary duty to voluntarily disclose information to the audit committee or turn over documents).

3 *Cf.* Service Agreement between Richard Alden and Skull Candy § 6, (last visited March 26, 2013) *www.sec.gov/Archives/edgar/data/1423542/000119312511115588/dex1020.htm* SEC agreement (requiring Skull Candy to cooperate with the Director in any investigation and provide information and documents).

4 *See, e.g.,* Model Business Corporation Act § 8.30.

5 *Cf. Nebraska Legislature ex rel. State v. Hergert,* 720 N.W.2d 372, 399 (2006) (holding that a public officer, in this case, a university regent, has a "duty to cooperate with investigators").

6 *See generally In re Abbott Laboratories Derivative Shareholders Litigation,* 325 F.3d 795 (7th Cir. 2003); *McCall v. Scott,* 250 F.3d 997 (6th Cir. 2001); *In re Caremark Int'l, Inc. Derivative Litigation,* 698 A.2d 959 (Del. Ch. 1996); see also *Nebraska Legislature ex rel. State v. Hergert,* 720 N.W.2d 372, 399 (2006).

7 *See, e.g., Diversified Indus., Inc. v. Meredith,* 572 F.2d 596, 607 (8th Cir. 1977).

8 *See Holmes v. Petrovich Development Company,* LLC, 2011 Cal. App. Lexis 33 (Cal. App. 3d Dist. Jan. 13, 2011). In contrast, at least one court has held that using a password-protected personal email on a company laptop to send emails to an attorney does not waive the attorney-client privilege. *See Stengart v. LovingCare Agency, Inc.,* 2010 WL 1189458 (N.J. March 30, 2010).

9 *See, e.g., Regas Christou v. Beatport,* No. 10-cv-02912 2013 WL 248058 at *13-14 (D. Col. Jan. 23, 2013) (sanction for failure to preserve text messages).