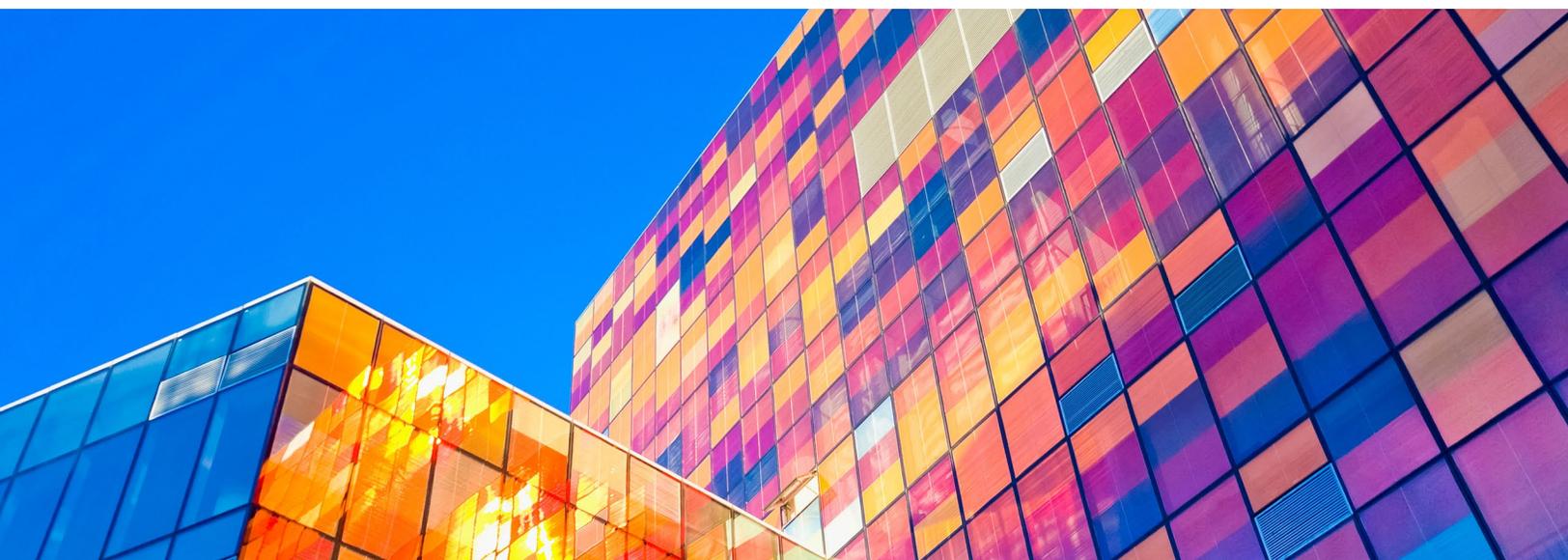


Handling the Tricky Aspects of Director Departures

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- *by Stewart Landefeld*

This Guidebook about “Handling the Tricky Aspects of Director Departures” is meant to be practical. I’m hoping its quasi-conversational nature helps you more easily consume the lessons imparted. Enjoy – and please share your own practice tips or your own anecdotes, for the next edition of this Guidebook!

1. Director Departures: Getting Out While the Going is Not Good

“I can’t sleep at night. I don’t agree with much of what is being said and done. I want to be responsible, but I am just not comfortable.” Over the years, I’ve heard this story from a lot of my director clients.

I get asked: “What is my moral obligation to stay on the board?” It’s a good question - and good directors should be asking that. Being a “fair weather” board member doesn’t sit well with most directors who think of themselves as able to help lead an organization through a challenge.

This dilemma becomes even more acute for those directors who have served on a particular board for only a handful of years. They’re worried about what that might signal to the market if they departed the board early. How will that sit with investors and analysts? How would it impact the directors that remain? And what about other boards that might decide not to take a chance adding them to their board because they look like a “jumper”?

It will depend on the circumstances but my guidance is pretty simple: before resigning, take these three steps and you’ll feel better and be doing the responsible thing:

1. Assess what’s making you uncomfortable.
2. Do all you can to seek to address the issues. That includes the need to create a record (that’s important, to come up with some sort of documentation) - that the board has taken all the possible steps to address any improper or possibly illegal actions identified at the company.

You want to establish a clear record that you - and any fellow resigning directors - have done all you possibly can to address the malfeasance, illegality or impropriety. Then, in anticipation of resignation, circulate to colleagues a draft statement of your reasons, the efforts taken, and how those efforts have either been stonewalled or otherwise failed to make progress.

3. Pass the baton. So then - before you leave remember that your successors on the board will need to grapple with many of the same issues. So do a thorough baton-passing to the directors who are remaining or coming on board.

2. 4 Things to Consider When a Director Mulls Leaving the Board

Let me back up a little and comb through what might go through a director's mind before deciding to leave a board. The director is close to the edge. The crisis is unrelenting. Both mentally and physically. It's taking over from their job and other board service. The director's significant other can't take the complaining anymore. The director thinks a departure is the only way out, but they do feel the pull of that moral obligation.

Here are four things to consider before a director makes that decision to pull the ripcord:

1. Illegal or unethical activity happening? - Is there a reason to believe that anything illegal or unethical is happening? If so, audit committee and board duties of oversight to inquire are triggered. Both counsel and auditors may need to be alerted.
2. Disagreements over company strategy? - If differences stem from a fundamental disagreement on the strategy or future of the company, you should constantly weigh: Is it better to stay and be an effective voice on the board? Or do you stop serving the best interests of shareholders by being a constantly dissenting board member?
3. Manner of resignation matters - If - probably with the advice of counsel - you as a director decide that it's in the company's best interests to resign, it's best to do so. But in a manner that is clear and amicable.
4. Public disclosure for resignations that aren't amicable might be required - Consider with counsel: Is there any obligation to make public disclosure of the circumstances involving departure from the board?

3. The "Leaving the Board" Roadmap: What Are My Fiduciary Duties?

Director behavior is at the essence of a director's fiduciary duties. This is what Delaware courts love to write about in their opinions.

That's easy for all the lawyers in the room to understand. But the notion of "fiduciary duties" is not a topic typically foremost on a director's mind. At least not until a corporate crisis comes along. That they want out if they can pull it off.

There is no easy answer for this type of situation. And it's raised more often than you might think. If you sit on a particular board long enough, it's only a matter of time before a crisis makes an appearance. It will just depend then on *whether a director thinks the company is handling the crisis responsibly* and in a way they're comfortable with. Or do the directors need to intervene? If so, what is the path of that intervention?

One of the key considerations here is to spot the issues that arise from a director's behavior in the face of a crisis. Of course, no one knows how a court would ultimately rule upon any given situation – but it's important to know what are the actions and deliberations that a court might wind up being intrigued about.

What might lead a court to find that a director's fiduciary duties have been breached due to their behavior in the wake of a crisis? Here's a roadmap to consider:

1. Starting place: the duty of oversight

- Defined as the *Caremark* standard: only “sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.”
- The duty in troubled situation: show good faith in continuing to establish a reporting system, and addressing issues that arise under that system.
- Particularly acute obligation for a committee chair or board chair.

2. Technical issues in charter documents to consider

- Is there anything unusual in the company's policies and procedures regarding director resignations, including any limitations in the company charter and/or bylaws?
- Do the charter, bylaws or corporate governance guidelines make the director entitled to consult independent legal counsel or other advisors at the company's expense, including for advice as to resignation and director's duties, obligations and responsibilities? Often the answer will be “not clearly so” so it may be time to speak to the general counsel or your own outside governance counsel for advice.

3. Independence considerations

Is there any risk that the director could be alleged to be dependent on the income from the directorship? (This is a topic that most of us don't think of - but it happens a surprising number of times with long-serving directors). Could the director's reliance on board compensation compromise independence in decision-making?

4. There's Illegality? There's Impropriety? "What Now" for a Director

If you counsel directors as I have for many years, you're familiar with that frantic call from a newbie director when they first learn about some illegal - or improper - activity at their company. They're freaked. Justifiably so. After all, we all learn from an early age that "the buck stops here."

The playbook for this is fairly straight-forward. Unfortunately, there can be human dynamics that serve as potential obstacles to hewing to the playbook. High emotions. Fast-moving developments. Conflicting - and perhaps even misleading - communications.

First and foremost, you should establish a clear record that you - and any other resigning directors - have done all that you can possibly do to address the malfeasance, illegality or impropriety. This is especially true for an audit committee member.

Under basic *Caremark* duties, and Section 10A of the Securities Exchange Act of 1934, once an independent director suspects - or becomes aware of - corporate malfeasance, the director's duties, obligations, and responsibilities include:

1. First, take reasonable steps to stop any ongoing legal or ethical violations.
2. Consider engaging the board in discussions with attorneys and accountants to uncover the apparent violations and figure out the steps that need to be taken by the company and the board. As these decisions involve legal judgments, directors should have access to expertise of independent counsel in making decisions.
3. Take steps to provide that the board's discoveries and actions are accurately and appropriately recorded in minutes of the audit committee and the board. Try to have any director concerns recorded consistently as the matter unfolds, to avoid any retrospective appearance that the director, or all independent directors, or all audit committee members, or the board as a whole, might have acted inappropriately once the issue was discovered.
4. Consider if the audit committee can rely on corporate counsel or should consider retaining its own counsel. Could, in this case, corporate counsel or his or her boss be so implicated in the issues as to not be able to be sufficiently independent to provide the service that the board needs?

5. I'm a Director and We Need to Fix This. But What If Other Directors Stonewall?

Perhaps the most painful scenario for a director who wants to do the right thing is one in which they find themselves very lonely. On an island. No one else on the board shares their views. Or at least, they're not willing to voice support and take action.

When a director's efforts to cause the board to take actions to fix a situation are resisted - and perhaps even blocked - the director might be forced into considering resigning as their ability to effect change has been compromised.

In that case, the departing director should seek independent counsel to help reduce any risk that regulators or a court could see the director as being drawn into the company's wrongdoing. This is true because directors bear responsibility for their own actions and those of the board until their resignation takes effect.

These matters tend to have a "long fuse" that extends back and starts in an innocent way. You might not realize it at first. Your board departure might just be the beginning of a long and agonizing farewell if things hit the fan.

Your lawyer should remind you that your resignation should be in writing - perhaps in draft form - and it then goes to the board chair, with instructions for it to be circulated to the full board. You should also consider if the resignation goes to shareholders as well.

And if you resign in protest, any resignation letter to the company will be public as it will be required to be filed as an exhibit to the company's Form 8-K announcing the resignation. That should be borne in mind as you put pen to paper.