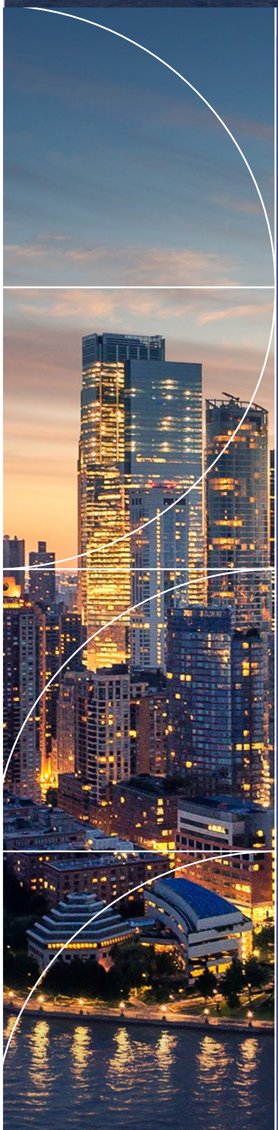
Seyfarth

Corporate Governance

The Duties, Responsibilities, and Potential Liabilities of Directors and Officers



Introduction

Welcome to this comprehensive flipbook on the fundamentals of corporate governance. Designed as a valuable resource to read for general learning about corporate governance and also to be kept on hand as such issues arise, it provides guidance to directors, officers, shareholders, employees, other investors, regulators, and experts across various fields such as crypto, cyber security, and economics.

Within these pages, you will find a concise description of the most important generally accepted principles of corporate governance. While corporate governance covers a broad spectrum of topics, we focus primarily on the principal duties of directors and officers as generally understood in the United States.

EVOLUTION OF CORPORATE GOVERNANCE

Corporate governance principles have continually evolved to adapt to the ever-changing business landscape. An example from a related issue is the 2019 statement of corporate purpose by the Business Roundtable marked a significant departure from the traditional shareholder primacy approach. It emphasized instead also considering the interests of various stakeholders, including employees, customers, suppliers, and communities, alongside creating value for shareholders.

As the business environment continues to evolve, we anticipate that the principles of corporate purpose and corporate governance will further develop, consistent with the needs and expectations of stakeholders.

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The Board of Directors

The Board of Directors of a corporation has broad discretion to make decisions for and act on behalf of a corporation.

A board of directors generally has the ultimate authority to make decisions for a corporation unless a majority of the board lacks independence on an issue or the majority of the board has conflicts of interest on an issue, or the board's authority has been delegated in specific part to senior management or a board committee. In general, delegation of authority is permitted if it is reasonable under the circumstances to delegate pursuant to a well-defined scope of delegated authority in a board resolution and the delegation is done in good faith.

Decisions by independent directors, which are consistent with their fiduciary duties of care and loyalty and oversight, are usually protected by the business judgment rule as long as the board members are independent on the issue in question, they do not have a conflict of interest, the voting board members take steps to be informed, and they act reasonably and in good faith. See page 13 below on the business judgment rule.

Claims that are most often brought against corporate directors and officers for wrongdoing are for alleged failures to observe their duties of care, loyalty, and oversight and include breach of fiduciary duty, failure of oversight, usurpation of corporate opportunities, and waste of corporate assets.

Duties of Officers

Fiduciary duties of officers of a corporation are similar to those of the Board of Directors but the breadth of the obligations are less wide and in some cases much less stringent than those that apply to the board. Clearly officers are expected to carry out the duties entailed in their employment and there is a great deal officers are expected to do and not to do. Of most relevance in this description of corporate governance obligations are the previously described instances where a board delegates responsibilities to an officer or officers.

Clearly, officers are expected to carry out any such duties with care and loyalty to the corporation. Self-dealing and letting personal interests outweigh the interests of the corporation will expose officers to liability for breach of the duty of loyalty. Negligence with respect to duties assigned to an officer is a breach of the duties of care and loyalty and possibly, depending on the circumstances, the duty of oversight. Recently, more cases have been filed by shareholder plaintiffs as derivative claims against individual officers who fail to carry out their duties with care and loyalty to the corporation's interests.

Responsibilities of Directors

Subject to the forgoing exceptions relating to lack of independence or delegation to others, Directors are responsible for:

- Making all major decisions on behalf of the corporation which have not been properly delegated to management or a committee.
- Seeing to it that the company has set up a reasonable compliance and risk oversight systems that give regular reports to the board, particularly where the information involved is important for the board and officers to be knowledgeable about, in order to properly meet their respective duties and obligations. Such systems should be set up with reasonable care and with a reasonable expectation that they will keep board members and depending on the circumstances some officers, reasonably informed.
- Determining overall business goals and objectives.
- Overseeing utilization of resources and budgeting expenses.
- Overseeing management of the business and deciding who will manage its daily operations.
- Under the emerging law of oversight duties of directors, it is important for directors and officers to be alert so as to identify and address promptly and with care significant risks to the corporation and its shareholders and other stakeholders, employees, its business, and its reputation and brand.

D&Os' Fiduciary Duties to Corporation and Shareholders

Duty of Care	Duty of Loyalty
Duty to Disclose/Candor	Duty of Oversight

Duty of Care | **Duty of Loyalty** | **Duty to Disclose/Candor** | **Duty of Oversight**

Duty of Care: Directors must act in good faith and with care to set up systems of information flow in order to be reasonably informed in taking actions necessary to make informed, thoughtful, and educated decisions on behalf of the corporation.

Duty of Loyalty: Directors must act in the best interest of the corporation and its shareholders. Corporate interests should take precedence over any personal interest of a director, officer, or controlling shareholder.

Duty to Disclose/Candor: When the board decides to ask shareholders to vote on an issue or a vote is required, directors must stay informed on efforts to fully disclose all material and relevant information within their knowledge after reasonable inquiry.

Duty of Oversight: The duty of oversight has been the subject of a number of cases recently, which apply to oversight by both directors and officers. With respect to directors, the Marchand case from the Supreme Court of Delaware has clarified the duty of oversight to include establishing reasonable information flow systems to assess the adequacy of directors meeting their obligations to be informed on a regular basis about material issues and risks within the corporation. Recently, cases have also confirmed that officers have similar obligations.

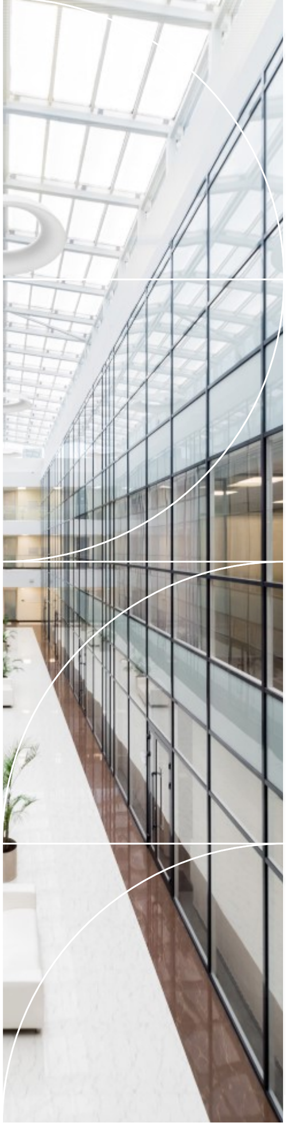
Board Expertise and Reliance on Experts

- A board member is not required to be an expert in every field that is relevant to potential risks to the company and is not required to have detailed technical knowledge of a subject area in order to fulfill his or her duties to a company.

- While board members should acquire a reasonable level of understanding of the company and its level of exposure to risks including, for example, cyber crime, they may instead rely on advice from those individuals in management or outside experts that they reasonably believe do have the expertise necessary to evaluate the company's risks and other material issues. Directors and officers may rely on such advice in deciding with reasonable care how to protect against various risks.

- Decision-making based on thoughtful and reasonable reliance on the expertise of others will likely justify application of the business judgment rule for the benefit of directors and officers who are not conflicted and thus likely will protect the company and themselves from a claim of breach of oversight.

- If directors have information that contradicts the information provided by a third party, then their reliance on the third party's statements may be considered unreasonable. Facts and circumstances concerning the reliability of the person providing advice should be considered with reasonable care by a director in reaching a conclusion on a course of action.



Board Delegation

- A board can delegate, where it is reasonable to do so, certain of its responsibilities with respect to certain identified issues, but it generally is not required to delegate if it has reasonably adequate resources to address issues with reasonable care and has no conflicts of interest. A board in its entirety can choose to retain authority to address issues where a majority of the board is independent.

- The board should ensure that there are reasonable and adequate reporting structures in place to keep the board adequately informed of any delegated topic/issue. See *Caremark and Marchand* cases from Delaware Courts.

- Often though, a board will give the authority to make a recommendation on certain issues (and in some cases, decision-making authority) to a committee. In recent years, boards have fairly frequently delegated topics like mergers and acquisition issues and how to address cyber risks to an audit committee, a risk committee, a technology committee, or a special committee. It is ideal, but not necessary, if the committee or some of its members have some facility for understanding a particular topic then at issue. Thus, if a committee has a member or members with some expertise in a topic, that can be helpful, but it is not required, if the board has the advice of knowledgeable officers and directors.

The Business Judgment Rule

- The business judgment rule is a legal presumption that protects corporate directors and officers who have no personal interest in the outcome of specific board issues or actions, and who, while reasonably informed, act in good faith and with an honest belief that they are acting with the lawful and legitimate interests of the corporation and shareholders in mind. Such directors and officers, will normally have protection from liability for breaches of fiduciary duty relating to such issues or actions.

- This doctrine is grounded in the belief that courts are ill-equipped and infrequently called upon to make business judgments on how corporations should be run or managed. Judges generally recognize that officers of corporations are more familiar with and better informed of what is best for the operation of the business than judges.

- Courts will accordingly afford great deference to board actions taken by independent directors who are reasonably informed on the issue in question and act in good faith in accordance with duties of care, loyalty, and oversight.

- The business judgment rule presumption is rebuttable and may be rebutted by evidence that the directors breached a fiduciary duty by engaging in self-dealing, making decisions tainted by conflicts of interests, or acting fraudulently, dishonestly, or in bad faith, or failing to act with reasonable diligence in informing herself of relevant facts and circumstance.

Practical Takeaways for the Board

Assess Board Composition and Qualifications: The board should periodically evaluate its composition and the corporate structure and charter of the company to determine whether there is sufficient experience and expertise and diversity on the board and an absence of conflicts and of domination by a conflicted controlling person to properly address the relevant issues facing a company. The duty of loyalty requires that directors always keep the best interests of the corporation as the primary goal when assessing options in decision-making.

Delegation of Authority: The board should determine what topics or issues it should reasonably delegate to a special committee, to another committee of the board, or to management. In making these determinations, the board should consider the expertise of any likely candidate or candidates and, in particular, make sure of the absence of any conflict of interest and of any domination by a controlling party on the part of the candidate. Other factors to consider in selecting committee members include having sufficient time to devote to meet their duty of care, experience as a board or committee member, expertise on an issue and, importantly, having good judgment.

Engage Experts: The board may engage third-parties and external advisors to obtain guidance and advice and achieve corporate goals. Before doing so, the board should consider the materiality of the issue, the cost, the expertise of the person or entity, the risk associated with possible leaking of information outside the company, and other factors.

Build Reporting Structures: In order to comply with its duty of oversight, the board must arrange for an adequate information flow to that board. In doing so, the board must carefully consider what information it needs to properly oversee risks and mission critical business issues that the company faces, as well as how it will receive that information in time to make it useful in their decision-making process.

Create and Review Internal Controls: The board should ensure that an adequate system of internal controls exists or should promptly create such a system of controls. Sufficient internal monitoring of compliance with company policies and government laws and regulations must be in place. The board should perform assessments of these internal controls and regularly get the report of an expert on such controls and understand how the company performance compares with industry standards.

The Board and Stakeholders: The board should understand significant company policies and procedures and understand how management is engaging the corporation's shareholders. They should keep in mind the corporate purpose adopted by the company. The board should also consider information flow to and treatment of other stakeholders such as employees, investors, customers, business partners, suppliers, the environment, the value of diversity, and other factors.

Obtain Guidance: When necessary, the board should take steps to see that inside and/or outside counsel try to evaluate litigation risk and what steps to take to avoid being sued.

About Seyfarth's Securities & Fiduciary Duty Litigation Practice

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For more information on Securities & Fiduciary Duty Litigation Practice, visit **www.seyfarth.com**.

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