

NACD Event Highlights

May 18, 2010 Breakfast Event

How to Prevent, Prepare For, and Deal with Lawsuits that Target Directors and Boards

Serve on a board for a meaningful time and chances are good that a director will be named as a defendant in a derivative lawsuit brought by an unhappy shareholder. With activist investing on the rise and the public growing increasingly distrustful of Corporate America and its leaders, why would any sane person choose to become a director? According to the three panelists at NACD New England's May 18, 2010 Breakfast Event, service on a board can be as gratifying as ever – but only if directors themselves take precautions to ward off personal liability stemming from shareholder lawsuits. These precautions were explored in detail by the panelists, leading to a provocative question-and-answer session.

Speaking first was panelist R. Robert Popeo. Widely recognized as one of the New England region's premier trial attorneys and chairman of the law firm of Mintz Levin, he has served as a director of numerous corporate, non-profit and educational institutions, as well as a member of the Executive Committee of the Massachusetts Business Roundtable and vice president of the Boston Bar Association. Popeo broadly surveyed the key considerations in preventing, preparing for, and dealing with lawsuits that target officers and directors. (Click [here](#) to view the slide presentation.)

Popeo observed that lawsuits targeting corporate directors and officers – and seeking access to their D&O insurance policies – are more frequent in times of financial crisis. He outlined the fiduciary responsibilities of directors under Delaware Law, describing the practical implications of the duties of care, good faith and loyalty. He highlighted the Business Judgment Rule as a crucial safe harbor from liability, as long as directors can demonstrate their decisions resulted from an informed, deliberative decision-making process and were made in good faith.

Popeo went on to outline the protections provided to directors by properly crafted corporate bylaws and indemnity contracts, and then commented in detail on issues related to D&O liability insurance. Noting that D&O insurance is “one of the most misunderstood areas of corporate governance,” Popeo emphasized its value as a means of filling in gaps in the indemnification provided to directors by the corporation. He described the provisions a D&O policy should include to provide “total sleep-at-night protection.” He concluded his remarks by describing the extensive series of actions directors should take if they become the targets in a shareholder lawsuit, beginning with record retention and concluding with steps to ensure success in litigation.

Following Popeo was John O'Brien, former chief executive officer of Allmerica Financial Corporation and, prior to that, president of Fidelity Management & Research. He serves as the non-executive chairman of Cabot Corporation as well as the lead director of The TJX Companies, Inc., LKQ Corporation, and BlackRock Mutual Funds. O'Brien has been active in a wide range of civic and non-profit organizations, and currently serves as the chairman of the Woods Hole Oceanographic Institute. O'Brien's comments

focused on the importance of establishing solid board processes and practices when dealing with shareholder lawsuits.

O'Brien described shareholder litigation as a "nearly inevitable" consequence of board service. He echoed Popeo in stressing the value of keeping accurate minutes of board meetings, including executive sessions, and advised caution in the use and retention of e-mail communications. He emphasized the importance of establishing a clear, thoughtful and rigorous board process for responding to shareholder lawsuits. Establishing strategic priorities is the first step, he said, advising directors to give the interests of customers, shareholders and employees a higher priority than their own personal concerns.

O'Brien then discussed other lawsuit process issues, including delegating responsibility for process management to individuals below the C-suite level, hiring outside experts, and managing internal communications. He concluded his remarks by reminding the audience sometimes it is in the long-term best interest of both the corporation and its directors to settle, rather than litigate.

Wrapping up the panel was Edward H. Pendergast, who practices as Pendergast & Company as a corporate financial consultant and as a managing director of the investment banking firm Dunn & Partners. The immediate past president of the New England Chapter of NACD, he served as president of both the Massachusetts Society of CPAs and Smaller Business Association of New England, and is active in a variety of civic and charitable organizations. Pendergast drew upon his experience as both a director and independent consultant representing shareholder interests in discussing the strengths and weaknesses typically demonstrated by boards, as well as the roles played by third parties engaged by boards involved in derivative litigation.

Pendergast began his remarks by posing the question, "Is there any sane reason to become a director?" He described his experiences as an outside third party retained to lead an internal investigation of corporate misconduct and to help a company defend against a hostile takeover offer, highlighting the importance of maintaining independence in these roles. Echoing both Popeo and O'Brien, he stressed the importance of keeping thorough minutes that clearly document the process used by the board to make decisions.

Pendergast observed that boards are typically less involved in reviewing and determining corporate strategy than they should be. He also pointed to risk management as a weak spot for many boards, commenting that companies need to be more transparent about their strategic appetite for risk. Echoing O'Brien, he said that settling shareholder lawsuits can under some circumstances be preferable to litigation when the company's long-term goals are the highest priority, cautioning that shareholders who sue directors are typically focused on the short term.

Questions from the audience following the panel discussion focused on the following concerns:

- Attorney-client privilege in shareholder derivative lawsuits;
- Pros and cons of keeping minutes of board executive sessions;

- What to expect on a day-to-day basis when directors become targets of shareholder lawsuits;
- Steps to ensure the adequacy of D&O insurance policies; and
- Shareholder lawsuits targeting directors of non-profit organizations.

NACD New England Chapter Chief Operating Officer PJ Blankenhorn adjourned the May 18th Breakfast Event by thanking the chapter volunteers and board members who assisted in organizing the program. She reminded everyone that NACD New England's next breakfast event, Governance in 140 Characters: The Impact of Technology in the Boardroom is scheduled for Tuesday, June 8th at the Newton Marriot Hotel.