Blogs
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Public Chatter

Handling Divergent Interests of Directors By the Book

This blog follows up on **a blog** about handing a director's right to corporate information if the interests of that director diverge from that of the company. The general rule is the directors do indeed have a right to access company information. In fact, that right to information is so broad that it's described as "unfettered." Directors need to be informed to do their job. That general rule ordinarily extends to privileged communications. In Delaware, directors are considered "joint clients" with the board in accessing those communications. But when a director's interest potentially diverges from the company's own interests, this is where it can get dicey. And there are exceptions to the general rule. The exceptions include: **1. By agreement** – When a director joins a board, it's possible the director could agree ahead of time (*ex-ante*) to not have access to certain information. Perhaps this is the board of a controlled company, where the majority shareholder – who is also the CEO – wants to limit what directors can see. Sometimes, it's the incoming director who wants the screen. This can be a challenge sometimes for directors as they still need to fulfill their fiduciary duty of care and oversight even if they do not have access to everything. The director's ability to limit the director's access to information is subject to limitations on the ability of any fiduciary to contract away its duties or agree to conduct that would lead to a breach of duties. The extent of these limits has not been fully determined, as Vice Chancellor Laster pointed out in the **seminal Kalisman case.** One other example: with a "fiduciary out" safety valve. A director nominee is a non-U.S. citizen, being considered for the board of a business that has access to classified U.S. Government information. Both the director and the company wish for a screen to be in place and effective, screening the nominee from access to any classified information before she becomes and during her tenure as a director. The incoming director could agree that she would have no access to that governmental information. To ensure that the director is not placed in a position in which she could violate her fiduciary duties of care or oversight, the new director and the company could agree that if and when she is ever advised by the general counsel or other counsel to the company that access to the off-limits classified information is necessary for the directors to fulfill their fiduciary duties, the director could agree to immediately resign. This would avoid her being caught in the dilemma of either risking violating fiduciary duties or jeopardizing herself or the company by needing to ask for access to proscribed information. **2. Director conflict handled by a special board committee** – There might be circumstances where a board wants to withhold information from a particular director. For example, if a director has a conflict regarding a transaction, the board might decide to create a special committee to consider – and make a recommendation – on the transaction. For which, that committee would exclude the conflicted director. Or maybe there is a dissident director on a board, where that director is part of a team seeking to wrest control in a proxy contest. Matters pertaining to the proxy contest might primarily be handled by a special board committee that excludes the dissident director. This type of circumstance does pop up on occasion. **3. Board has an interest adverse to a director** – It's fairly rare, but it does happen. Maybe the board has been investigating a director for a possible violation of a code of conduct issue. Or maybe the director has run afoul of another policy applicable to the board. In this case, the board – and a board committee – is within its rights to withhold as privileged the advice of its counsel. The director under investigation can be barred from access to the board's – and committee's – deliberation and privileged communications as the director doesn't have a reasonable expectation that they were a client of the board's/committee's counsel. The legal roadmap here – particularly if your situation involves a Delaware company – is best explained in the *Kalisman v. Friedman* (Del. Ch. 4/17/13); *In re CBS Corp. Litig.* (Del. Ch. 7/13/18); and *Schnatter v. Papa John's International* (Del. Ch. 2/25/19) decisions. In *Kalisman,* VC Laster lays out the standards for the last two exceptions I mentioned, making it clear that transparency matters – and pointing out that the law is uncertain on the degree to which an *ex-ante* agreement can protect a director who needs to fulfill fiduciary duties. The *CBS* and *Schnatter* cases dig deeper into the standards, making it clear that the facts matter. [A great piece written on this topic is "Limitations on Director Access to Company Information," by Joseph McLaughlin and Shannon McGovern in the New York Law Journal back in 2019.] **What to Consider** Particularly when these situations are contentious, it's nice to have a clear policy about what is – and isn't – permitted. Litigation can ensue and having such a policy can help a board's case. Or it might help stave off the lawsuit in the first place. So a board might consider adopting a provision in a board's code of conduct that acts essentially as a confidentiality policy that clearly lays out what the general rule is for a director's access to corporate information – and then detail what the exceptions are.

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