

Corporate Law Alert



After Enron and Sarbanes-Oxley, What Should Directors Do?

By Robert C. Beasley and Michael T. Larkin

After the Enron debacle, and in this era of increased public scrutiny *ala* Sarbanes-Oxley, what should directors be doing to do their job right? The following is a quick primer on things directors should be considering:

Seek, Ask, and Find. As a director in this era, you now have the authority to ask as many questions as you want and to speak as loudly as you can. Pursuant to the Sarbanes-Oxley Act (the "Act"), now all companies listed on exchanges are required to have a majority of the board independent. Audit committees must satisfy additional independence criteria. Other committees, such as compensation and nominating/corporate governance committees, will likewise consist of independent directors. Just as the SEC regulations implementing the Act authorize audit committees to hire outside special counsel and other professionals, so these other committees, and independent directors as a whole, are also frequently hiring outside advisors. All of the new regulation is designed to create what Professor Jeffrey Sonnenfeld described in the September 2002 issue of the *Harvard Business Review* as a "robust" board: "The highest performing companies have extremely contentious boards that regard dissent as an obligation and that treat no subject as undiscussable."

The Question of Liability. This question should be on each director's mind, but directors should find comfort in that the substance of the "business judgment rule" remains applicable in today's environment. The business judgment rule, as fashioned by the courts, protects directors who act with due care and reasonably rely on management and advisors in making business decisions. In fact, in two recent court decisions, the Seventh Circuit Court of Appeals and the Delaware Chancery Court applied the same standards regarding independent director liability that had applied pre-Enron. In *Abbot Laboratories Derivative Litigation*, 325 F.3d 795 (7th Cir. Mar. 28, 2003), the Seventh Circuit dealt

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— Chief Justice Norman Veasey

with allegations that the independent directors had done nothing during a six year period in which the FDA repeatedly served notice of safety violations at one of Abbott's major divisions, resulting in the largest civil fine ever imposed by the FDA and a further loss of about \$250 million in products. In analyzing the directors' failures in this case, the Seventh Circuit did not impose any new standard to judge director's decisions. Similarly, in *Walt Disney Co. Derivative Litigation*, No. 15452 (Del. Ch. May 28, 2003), the Delaware Chancery Court scrutinized the actions of the Walt Disney board using the long-standing business judgment rule. Thus, directors will still have the protection of the business judgment rule when

they make corporate decisions with the exercise of due care. Due care essentially means:

- that directors have acted to assure themselves that they have the information required to take action;
- that they devote sufficient time to the consideration of such information; and
- that they obtain advice from experts and counsel.

In addition, the board should always produce a good "paper trail," documenting that they took the time and effort to perform their duty of due care.

In this post-Enron era, directors have the protection and authority to speak up. As Delaware Chief Justice Norman Veasey has remarked, "Directors who are supposed to be independent should have the guts to be a pain in the neck and act independently."

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