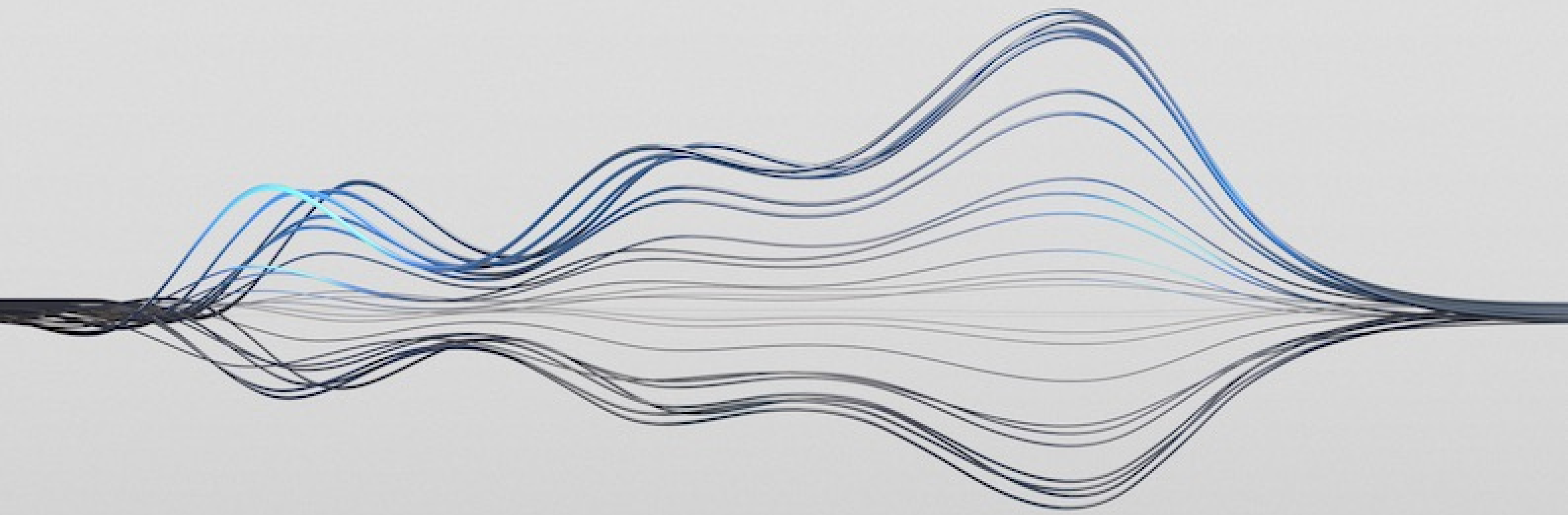
UNITED STATES

Global Guide to Directors' Duties



DLA PIPER

United States

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Corporate entities

What type of company is typically used in group structures?

In the United States, entity choice is an important legal determination and choosing the right entity structure depends on a number of factors, including desired management structure and tax treatment. The most common type of company used in group structures is a corporation, specifically a "C-Corporation". This guide therefore focuses on the management of C-Corporations.

Note: Corporate laws differ among the 50 US states. This guide provides general answers under Delaware corporate law, where approximately two thirds of Fortune 500 US companies are incorporated.

Types of director

What is a "director"?

The oversight of a corporation is undertaken by its board of directors. A director is a member of the board of directors, which is generally responsible for managing or directing the management of the business and affairs of the corporation. A director (also called a "board member") is distinct from the company's stockholders, or owners, and distinct from the company's executive officers or management. A stockholder, executive officer or other member of management can serve as a director if elected by the stockholders.

What are the different types of director?

In general, there are not multiple types of directors under Delaware law: all directors are members of the board with the same voting power, duties and responsibilities. Some companies may appoint board committees to oversee distinct aspects of the business, such as an audit committee that oversees the company's audits and financial affairs. It is also common to appoint a "chairperson of the board" and /or "committee chair" who is a member of the board of directors responsible for presiding over board or committee meetings and may have certain other specific delegated duties or authority.

Eligibility

Who can be a director?

In general, the stockholders of a corporation may elect anyone to serve as director. In the United States, there is generally no requirement that directors be stockholders; to have an employee representative on the board; or other generally specified legal qualifications for directors. The company's certificate of incorporation (sometimes called the "charter") or its bylaws (the "bylaws," and together with the charter, the "charter documents") may prescribe qualifications for directors, such as minimum or maximum age requirements or a requirement that the company's chief executive officer serve on the board, although in practice that is less common. In addition, regulatory schemes imposed by other, non-corporate US laws may limit a person's ability to serve as a director.

Some examples of other limiting regulatory regimes are:

- The Securities and Exchange Commission may limit the ability of certain "bad actors" (such as individuals who have committed fraud or other crimes) from serving as a director of a US public company.
- The Clayton Antitrust Act limits the ability of directors to serve on the boards of directors of certain competitive companies.
- The Committee on Foreign Investment in the United States (CFIUS) may determine that a certain corporate transaction (such as a merger whereby a board is replaced with foreign nationals) is improper because it violates national security.

Additionally, a company's charter documents may provide for other director qualifications.

Minimum / maximum number of directors

Delaware corporate law requires that a board have at least one director and otherwise does establish a minimum or maximum number of directors. The number, or the manner for establishing the number, of directors must be fixed in the charter documents. Depending on the facts, other regulatory regimes may apply that require a number of directors greater than one. For example, the "independence" and committee requirements for publicly-traded companies make it logically difficult to have a board with fewer than three independent directors.

Appointment and removal

How are directors appointed?

Directors are generally elected by stockholders, provided that the charter documents may provide (and commonly do provide) that the board may fill any vacancy in the board. For example, the charter documents typically permit the board to increase the size of the board and to fill vacancies on the board, which effectively permits the board to appoint directors until the next meeting of stockholders at which directors are elected.

How are directors removed?

In general, any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares of stock then entitled to vote at an election of directors pursuant to the company's charter. A notable exception, however, is that in companies with "classified" boards (in which directors are divided into "classes" that are elected staggered multi-year terms), stockholders may remove directors only for cause unless the charter provides otherwise. In situations where companies attract investment from funds or other sophisticated investors, particularly in private companies, it is common for those investors to have voting or similar agreements that allow them to control the removal and appointment of designated directors.

Board / management structure

Typical management structure

The board of directors generally appoints the company's executive officers, such as the company's chief executive officer, president, secretary, treasurer and any vice-presidents, to manage the day-to-day affairs of the company.

How are decisions made by directors?

Directors have the duties of care and loyalty to the corporations that they oversee. Directors must exercise these duties by becoming informed, prior to making a business decision, of all material information that is reasonably available, including reasonable alternatives (duty of care), and by acting in the best interests of the company and putting the company first (duty of loyalty). Directors typically discuss actions at one or more meetings, ask management questions and consider a decision and its alternatives. Any director with an interest in the outcome of the decision should disclose all material facts relating to that interest and recuse themselves from the deliberations and decisions regarding the matter. Once the board has satisfied its obligation to become informed, it will vote on the action, either by a vote at the meeting or via a written consent. Usually a majority vote is required to approve an action, although the nature of approval depends on a number of factors, including the company's charter documents and whether the company is seeking a vote of the independent directors to protect the board against claims of self-dealing or conflicts of interest.

Authority and powers

The board of directors generally has the power to manage the corporation, including the power to appoint and remove officers of the corporation, and approve fundamental transactions such as issuances of stock, mergers and acquisitions and amendments to the company's charter documents. Usually, boards will appoint officers to manage the day-to-affairs of the company and delegate to them the power to bind the company on routine matters, subject to certain limitations. Unless otherwise provided in the company's charter, directors generally do not have the power to act alone, and decisions must be made by the board, or a committee or individual to which the board has delegated power.

Delegation

Directors may delegate day-to-day responsibilities to management. The officers have the titles and duties as are stated in the bylaws (or in a resolution of the board not inconsistent with the bylaws) and includes an officer as may be necessary to enable the company to sign instruments and stock certificates (traditionally referred to as the secretary). Generally, as a U.S. corporate law matter, a company would have a president who acts as the company's chief executive officer, a secretary who records the proceedings and meetings of the company's stockholders and directors and authenticates official records, and a treasurer who oversees the company's finances (often a chief financial officer). The board may also appoint one or more vice-presidents and other officers of the company, with the duties outlined in the company's bylaws or resolutions of the board. Typical officers may include a chief operating officer, chief revenue officer or head of sales, chief technology officer, general counsel, or such other officers that may be important to the company's business.

Directors may not delegate their personal judgment or decision-making authority, such as their authority to choose the officers or to vote as a director on board actions (there is no "director proxy" in the United States). However, the board may delegate certain decisions of the board to a specified committee. For example, the board may delegate the ability to set executive compensation to a compensation committee.

Duties and obligations of directors

What are the key general duties of directors?

Directors have the duties of care and loyalty to the corporations that they oversee. The duty of care is the duty to act with the level of care that an ordinary, prudent person would exercise under the same circumstances. In addition to becoming informed about decisions, the duty of care focuses on refraining from engaging in reckless conduct, intentional misconduct or gross negligence. The duty of loyalty is the duty to act in the best interests of the company. It includes disclosure obligations, oversight obligations and a duty to not take actions that are harmful to the company or its stockholders for the benefit of directors or management. The duty of loyalty includes a duty of good faith, which requires directors to take actions performed with an honest belief that such actions are in the best interests of the company.

What are directors' other key obligations?

The board generally oversees and manages the business and affairs of the company and must approve certain fundamental actions, such as appointing or removing the company's executive officers, amending the company's charter documents, approving the issuance of stock, or approving a sale of the company. Certain fundamental transactions may also require the approval of the company's stockholders under the Delaware General Corporation Law or the company's charter. As part of its duty to remain informed, a board would ordinarily require management to present regular reports regarding material aspects of the company's business, including its financial results. In the event the company is in or nearing insolvency, directors may be personally liable for actions or inactions the company takes. For example, if the company is unable to pay taxes to taxing authorities or wages to employees, the director may face personal liability.

Transactions with the company

The duty of loyalty requires directors to act in the best interests of the corporation and its stockholders, and not to engage in conflicted or self-interested transactions that are not in the corporation and its stockholders' best interest. A board considering a transaction in which one or more directors has a conflict of interest can implement procedural safeguards to protect against claims of a breach of duty of loyalty. For example, the director may disclose all material facts relating to a conflict of interest and recuse themselves from the deliberations and decisions regarding the matter, the board may form a committee of directors without conflicts to negotiate and enter into the transaction, and/or the transaction may be made subject to the informed, uncoerced vote of the unconflicted stockholders.

Liabilities of directors

Breach of general duties

Generally, a company (directly) or its stockholders (derivatively, on behalf of the company) may bring an action against a director for breach of fiduciary duty of care or loyalty. The court has broad powers to grant remedies for a breach of fiduciary duty, which can include requiring the rescission of a transaction or the payment of monetary damages.

Liabilities on insolvency

Directors are generally not personally liable for obligations of the corporation, even in the event of its insolvency. In such circumstances, however, the corporation's creditors, as the residual beneficiaries of the company, are authorized to sue the company's directors derivatively for breach of fiduciary duty. Employees may also sue directors for unpaid wages in certain states.

Other key risks

A key risk is a derivative action by a company's stockholders for breach of fiduciary duties, which commonly happens in connection with M&A activity, securities offerings, data breaches, or other significant transactions or events. In addition, directors may be held personally criminally or civilly liable for misconduct by the company or its employees, including violations of securities laws, environmental laws or the Foreign Corrupt Practices Act. Additionally, directors may be held jointly and severally liable for unlawful share purchases or redemptions or dividends. Under "bad actor" laws, directors who have committed fraud or other crimes may be barred from serving as a director of a company offering or selling securities in the future.

Protection against liability

How can directors be protected from liability?

Directors can be protected from liability by:

- A written provision in the company's certificate of incorporation that exculpates a director or officer from personal liability for breach of the duty of care (a company may not exculpate a director from liability for a breach of the duty of loyalty).
- Indemnification in the company's charter documents and in written indemnification agreements between directors and the company, including advancement of litigation costs.
- Obtaining directors and officers insurance.

What practical steps can directors take to avoid liability?

To avoid liability, directors should:

- Ensure that the company's charter documents provide for exculpation and indemnification for directors.
- Ensure that the director has an appropriate indemnification agreement with the company.
- Ensure that the company has obtained sufficient D&O insurance.
- Conscientiously and faithfully perform their duties as a director, including by asking questions of management, thoroughly understanding the company's compliance program and policies and acting in good faith and with loyalty to the company and its stockholders.
- Hire and retain skilled and effective management who deliver strong results for the company.
- Thoroughly document meetings of the board and the director's appropriate oversight of the company.

- Make robust and accurate disclosures regarding conflicts of interests and transaction details and alternatives to the company's stockholders.
- Adopt procedural safeguards in the event of a conflicted or other high-risk transaction, such as by requiring a stockholder vote and/or a vote of a special committee of non-conflicted directors for transactions with directors.
- Obtain and rely on expert advice as to complicated matters (such as financial advisors on valuation, IT consultants on data breach remediation, or legal advisors on complicated questions of law).

Additionally, specific practical steps should be taken in certain circumstances, such as ensuring true and complete disclosure is set forth in securities filings, following up on red flags that may indicate misconduct, creating special procedures for corporate transactions, and considering creditors as the company approaches insolvency.

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