The must-have record: Board meeting minutes

It is more imperative than ever that what happens behind the closed doors of board meetings be preserved to answer any claim of irregularity.

By Roscoe C. Howard Jr., Mark E. Nagle and Christopher M. Loveland

Hardly a day passes without news of allegations of corporate mismanagement leveled by a government agency, an aggressive plaintiff's lawyer, or an internal watchdog unit within a large company. Directors and officers find themselves scrutinized, questioned, challenged, and sometimes sued in their personal capacities for a multitude of alleged sins of commission and omission. Amid this maelstrom, the question occasionally arises: What kind of record should a board of directors maintain of its proceedings?

In this litigious age, when any paper or electronic record can be a potential weapon in the hands of an adversary, are the directors — and perhaps even the company itself — better off with only the most abbreviated minutes of proceedings, or perhaps none at all? Tempting as the notion may be to simply keep no record at all, or perhaps only the most cursory record needed to attain minimum compliance with state law, any board following that course of action will, in the end, create more problems than it solves.

Public outcry, sweeping changes

Consideration of this question must begin with an assessment of the current public climate, which in turn informs and influences the political, regulatory, and judicial environments in which the corporation must exist. The public outcry over corporate scandals prompted Congress to enact the Sarbanes-Oxley Act of 2002 (SOX), which resulted in sweeping changes in corporate governance. SOX was designed to create within publicly traded companies a culture of compliance with the law, and toward that end the act set high standards for preparing and maintaining accurate and complete corporate financial records and financial statements.

SOX has changed the climate in which boards of directors must now operate. Their acts will have a certain sense of transparency, and the consequences of any malfeasance will be severe. One possible reaction to the increased scrutiny and liability is to deny access to the very evidence that may be used to prove the SOX violations: the minutes and notes of board meetings. However, as this article will explore, the scrutiny will come nevertheless.

One of the assumptions of the advice we provide below is that the discussions of the board are for the benefit of the shareholders and the company, and any actions taken or acquiesced in would withstand scrutiny. In that case, contemporaneous evidence to support such a conclusion is vital to proof of the actual intentions of the board. Although lawsuits and shareholder actions will not be prevented, the contemporaneous account of what was decided and how provides a record that may be relied on by testifying board members and investigating authorities that will focus and sharpen recollection and probes.

SOX has placed a greater burden on boards to take responsibility for the reporting duties of their companies. As discussed below, the act makes publicly traded companies susceptible to easy inspection, audit, and reporting of possible violations. As shareholders recall the scandals, it should be anticipated that these reports, requests for audits and inspections, and lawsuits will become more prevalent than in the past. As a result, it is imperative that what happens behind the closed doors of board

Roscoe C. Howard Jr. and **Mark E. Nagle** are partners and **Christopher M. Loveland** is an associate in the Washington, D.C., office of Sheppard Mullin Richter & Hampton LLP (www.sheppardmullin.com). Immediately prior to joining Sheppard Mullin, Howard was United States Attorney for the District of Columbia, and Nagle was chief of the Civil Division in the U.S Attorney's Office.

meetings be preserved to answer any claim of irregularity.

Preserving 'the witness'

We speak as seasoned attorneys who have experienced the courtroom. Motions, directives, and statements get misinterpreted, reinterpreted, or even fabricated with the passage of time — and sometimes without the passage of time. Preserving a "witness" whose testimony will not change over time — whose allegiance will not vary with corporate administrations and who will not bend with political agendas — is imperative. That witness is the accurate minutes of the board meeting.

Recognizing what SOX has wrought is important to understanding why this is so important. SOX places specific, affirmative duties on officers and directors to ensure greater accountability to company employees, shareholders, the investing public, and regulatory and law-enforcement agencies. Perhaps the most significant such duty is the requirement that principal executive and financial officers personally certify all annual and quarterly reports filed with the Securities and Exchange Commission. The officers not only must certify that they have reviewed the report, but also are required to attest that the report does not contain any untrue statement of a material fact or omit a necessary material fact, and that the financial statements and financial information contained in the report "fairly present" the financial condition of the company.

The gravity of this obligation can hardly be overstated. In its "Final Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports," the SEC indicated that complying with generally accepted accounting principles (GAAP) alone was not sufficient to satisfy Section 302 of SOX. Congress "intended this statement to provide assurances that the financial information disclosed in a report, viewed in its entirety, meets a standard of overall material accuracy and completeness that is broader than financial reporting requirements under generally accepted accounting principles." According to the SEC, "fair presentation" includes "the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events, and the inclusion of any additional disclosure necessary to provide investors with a materially accurate and complete picture of an issuer's financial condition, results of operations, and cash flows."

The officers who certify the report are also responsible for establishing and maintaining the internal financial controls of the company. They must certify that they evaluated the effectiveness of these controls within 90 days prior to the issuance of the report and present in the report their conclusions regarding the effectiveness of their internal controls based on that evaluation. No longer can principal executive and financial officers claim ignorance over the financial condition of their company. They are now personally responsible for ensuring that their company has strict internal controls to prevent accounting irregularities and financial fraud.

A thorough paper trail

Thus, the overriding purpose of Sarbanes-Oxley is to place a greater burden on corporate officers and directors to ensure that the finances of their companies are in order and properly documented. Indeed, SOX mandates strict record-keeping. Maintaining a thorough paper trail is thus critical to demonstrate compliance with a board's expanded fiduciary obligations to the company and its shareholders. One way to effectively document the decisions made by officers and directors is to prepare and maintain detailed minutes of board meetings.

> ***Keeping only the most cursory record will, in the end, create more problems than it solves.***

It bears repeating: The fundamental objective of greater accountability and disclosure mandated by SOX, and backed by its strong criminal and civil sanctions, compels the conclusion that maintaining thorough minutes of board meetings is essential. An appropriately detailed record will allow officers and directors to demonstrate that they fully complied with their financial oversight obligations, and could become a critical source of contemporaneous evidence in any government investigation or private litigation.

Moreover, the very fact that a company did not maintain minutes of board meetings would almost inevitably inspire regulators or law-enforcement officers, should the company fall under their scrutiny, to redouble their efforts and dig deeper into a company's financial records. A failure to keep and maintain minutes of board meetings could well be construed as an affirmative act by directors to cover up their failure to properly monitor the financial condition of the company — or, worse, to participate or acquiesce in some form of financial fraud. In fact, the failure to maintain these minutes is subject to almost any interpretation at all, and certainly one that is not controlled by the board.

Even a cursory glance at a daily newspaper is enough to show that lawsuits seeking to hold officers and directors personally liable for their actions are growing increasingly common. Indeed, the Delaware Chancery Court's recent decision in the *Emerging Communications* case holds that a director with a "specialized expertise or knowledge" can be held to a higher standard than other directors — in essence, a known-or-should-have-known test. Although the long-term implications of this decision (for which the appeal time has not run as this article goes to press) are not yet clear, they are potentially far-reaching.

Failure to maintain minutes would almost inevitably inspire law-enforcement officers to redouble their investigative efforts.

Against this backdrop, the crucial importance of accurate board minutes is obvious. Detailed and accurate minutes could be the only way to satisfy a judge or jury that the officers and directors of a company took appropriate action and that they were not "asleep at the switch." No officer or director wants to face an attorney in a deposition — let alone a jury in a courtroom — and have to admit to a complete lack of documentation of the reasons why the particular decision then under challenge was taken.

It is thus critical that officers and directors keep thorough minutes of every board meeting and to document their compliance with the requirements of Sarbanes-Oxley. Boards and directors do otherwise at their peril. ■

The authors can be contacted at rhoward@sheppardmullin.com, mnagle@sheppardmullin.com, and cloveland@sheppardmullin.com.