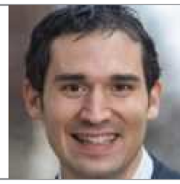
Raiders, Activists, and the Risk of Mistargeting

By Zohar Goshen and Reilly S. Steel



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COLUMBIA LAW SCHOOL'S BLOG ON CORPORATIONS AND THE CAPITAL MARKETS

Skadden Discusses Crisis in the C-Suite: A 10-Step Plan

By Katherine D. (Kady) Ashley, Ryan D. Junck, Bora P. Rawcliffe and Vanessa K. McGoldrick October 27, 2021

Comment

It's an all-too-common occurrence. A senior executive is accused of wrongdoing — sexual misconduct, bullying, financial fraud, a conflict of interest or other conduct posing a compliance or integrity concern. Suddenly, directors find themselves thrust into the center of a crisis, forced to make critical decisions on a short timeline, often in the glare of a public spotlight.

It's a time for clearheaded thinking and a game plan. Here's a 10-point guide for directors for the first few, critical days.

1. Make a quick, preliminary assessment of the seriousness of the allegations and establish a proper investigation structure: The first step is to assess the allegations and determine whether the conduct, if true, could constitute a criminal offense, a regulatory violation, a violation of company policies or a breach of the executive's employment agreement, or raise a reputational concern. Boards often assign these tasks to the audit committee or set up an independent committee to oversee the investigation. You may want to set a schedule for reporting progress to the full board.

2. Retain credible advisors: Outside counsel is typically retained to conduct a thorough, investigation. By employing outside counsel, written and oral reports can be protected by attorney-client privilege or work product doctrine. Directors should consider the advantages of truly independent advisers, without close ties to the management involved, and whether the executive should be offered his or her own counsel. If experts, such as forensic accountants, are necessary, they should be hired by counsel to keep their work within the attorney-client privilege.

3. Be on the lookout for additional or related whistleblower reports: Once headline-catching allegations surface, others often follow. The board should ensure that the company's reporting hotline is properly monitored so that any related allegations are identified, escalated and investigated promptly, including any related past allegations. At the same time, the scope of the investigation should be clearly defined to prevent mission creep.

4. Determine what, if anything, the company must disclose and how: Assess, with outside counsel, whether any disclosures are required to regulators, other authorities or investors. Consider, too, whether the company needs to delay any corporate activities such as bond offerings, stock repurchases or other transactions where the company must disclose any material non-public information, or represent that it has none.

The company may face multiple demands for information from a range of stakeholders, including employees, counterparties, shareholders, the media, etc. Responses should be consistent across multiple stakeholders, and accurate, and disclosure obligations should be monitored and reevaluated as new information becomes available. The management group "in the tent" on the issue must be selected to ensure that relevant divisions of the company are not going about business as usual where disclosure issues may need to be considered or could have an impact on the business.

Be wary of leaping to premature conclusions. Do not be afraid to say, "We don't know yet, but these are our priorities and values, and here's what we're doing."

5. Don't forget about the auditors: Directors must assess whether the nature of the allegations obligate them to make disclosures to the company's auditors or whether disclosures should be made as a matter of prudence. If details of the investigation are shared with the auditors, particular care must be taken to preserve the attorney-client privilege. At a time when auditors face increased scrutiny of their work by regulators and others, directors should anticipate that auditors may request details of any misconduct that could have an impact on a company's financial statements or the integrity of management involved in preparing and signing them.

6. Develop a public relations strategy: It is not always possible to keep these kinds of investigations confidential. The risk of leaks and/or the need for mandatory disclosures may tip the scales in favor of a public statement early in the investigation. At a minimum, the board should plan ahead for the possibility of a leak. Premptive disclosure may allow the company to better control the narrative. The board, with outside counsel and potentially a trusted public relations consultant, should weigh the pros and cons of any public statements, develop a plan for their timing — and prepare to deviate from those plans and expedite disclosures if circumstances change.

It is critical to have advisors with peripheral vision, not solely focused on legal ramifications, and consider how messages will be received by different stakeholders that are important to the company.

7. Consider suspensions or recusals: The board should consider whether it is necessary or appropriate, based on the type and severity of the allegations, to suspend the target of the allegations, or limit his or her authority or involvement in certain matters or business activities during the investigation.

8. Understand root causes: As the investigation progresses, the board should focus not just on whether the allegations are substantiated, but also on analyzing any root causes of the purported issue. Early analysis of these issues will help frame remediation efforts and assist in deciding on any disciplinary action.

9. Think ahead about remediation and disciplinary options: If the allegations of misconduct are substantiated or concerns remain about the executive's conduct or integrity, the board will have to decide how to respond with regard to the executive. Options include decreased compensation, demotion or removal of the executive, and/or changes to the governance structure. If the board deems it necessary to remove the executive, it will need to plan for succession, too. Should the investigation reveal systemic problems, the board will need to address them, such as by enhancing the company's compliance program and internal controls, or possibly via changes to governance and disciplinary processes.

10. Keep litigation risks in mind throughout: If an investigation becomes public or the allegations of misconduct are confirmed, the board should expect civil suits by shareholders, any victims and, possibly, the executive at the center of the crisis. That prospect needs to be in the back of directors' minds from the earliest stages, and should inform the board's decisions along the way. Taking the right steps with counsel from the outset will help to ensure that work product and reports related to the investigation are protected by legal privileges and do not need to be disclosed in any litigation.

Getting the first few days right will save your company time and money, and may help to minimize legal and regulatory risks, reputational injury and business disruption. It will also demonstrate to investors, employees, customers and counterparties that the company is well governed, has strong controls and is committed to compliance and ethical behavior.

Common Mistakes to Avoid

- Delaying the start of an investigation, or failing to investigate additional or related reports
- Failing to consider external optics, including potential conflicts, with respect to oversight of review and outside advisers
- Inconsistent communications, external or internal, and delayed disclosures
- Ignoring root causes and related remediation

This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm's memorandum, "Crisis in the C Suite: A 10-Step Plan," dated Fall 2021.