Directors and "Unfettered" Rights to Company Information

Can directors share information learned in the boardroom with their designating investors?

BY DOUG RAYMOND

A recent case involving petroleum coke seller Oxbow Carbon and one of its significant investors, Crestview, shines a light whether there should be "unfettered" director rights to all information in the boardroom.

Crestview had invested in Oxbow Carbon in 2007 and as a result had the right to appoint two directors to the board. By 2014, Crestview apparently wanted to pull out and wanted the company to either buy out its units or sell the entire company. The majority investor, who was also the CEO, disagreed.

As a consequence, Oxbow Carbon alleged, Crestview persuaded its appointed directors to assist them in a "secret mission" to replace the CEO. Thereafter, the directors allegedly took steps to effect Crestview's objectives. In response, the company filed a complaint alleging that the Crestview-appointed directors had breached their fiduciary duties by becoming adverse to the company, and thus should no longer enjoy "virtually unfettered informational rights that included access to the company's privileged documents."

> Companies should have clear policies governing when, and with whom, board members may share information they receive as directors, and when they can be excluded from sensitive discussions.

At many private and public companies, some of the directors act also as representatives — sometimes even employees — of certain investors, as was the case at Oxbow Carbon. When a director is an employee or representative of a private equity or venture fund or other investor in the business or is an industry expert backed by an investor during a contested election, the question generally arises: What, exactly, may these designated directors share with the investors who put them in the boardroom? Surprisingly, the answer is not always clear, and there can be significant consequences for the directors, and the investors, if this issue is not properly handled.

Under traditional corporate law principles, including in Delaware, a sitting director's right to information about the company is "essentially unfettered in nature," regardless of any affiliation he or she may have with any of the company's investors. However, this right is tempered by the director's own fiduciary duties of loyalty, which includes the obligation to keep confidential information learned as a director. Nonetheless, courts have recognized that directors who serve as representatives of an investor or investor group will often want to share information with the investors and have generally permitted this, at least where the director takes reasonable care to keep the information confidential and investor's interests are not hostile or adverse to the corporation.

The Oxbow Carbon case gave the Delaware Chancery Court a chance to address this topic of director information rights in March and showed how difficult it is to restrict the information flow to any director.

In the Oxbow Carbon case — *In re Oxbow Carbon LLC Unitholder Litigation* — Chancery Court Vice Chancellor J. Travis Laster considered whether an investor-designated director's interests had become adverse to the company and whether, accordingly, the director should be denied access to relevant corporate books and

records (although Oxbow Carbon is a limited liability company, its operating agreement imposed the same fiduciary obligations on the directors as would apply to directors in a Delaware corporation). The background for the dispute was the assertion by Oxbow Carbon that Crestview had developed interests adverse to the company and was seeking an exit from its investment.

Although the Crestview directors had acted in secret to pursue goals that clearly were not shared by the company's management, including replacing the CEO, Laster deemed this insufficient to show direct adversity to the best interests of the company. Laster concluded that, at least on the record before him, the directors could have had other motivations for their actions, which may not have been contrary to the best interests of the company. Accordingly, he found that it was not appropriate to limit the directors' access to informational rights.

The Oxbow Carbon case raises the question of whether designated directors should have access to information if they are going to share it with their investors and the consequences for the investors if they do. When a director chooses to share confidential information he or she learns in the boardroom with a stockholder, unless that stockholder has agreed to restrict its use of the information, the director effectively puts himself at risk of breaching his own fiduciary duties to the company if the investor uses the information to the detriment of the company. Moreover, some commentators have suggested that the sharing of confidential information by a director with his or her constituents may carry with it fiduciary duties that are imposed on the recipient of the information.

At the least, this implicates securities law issues around selective disclosure and insider trading, as well as competitive issues and untimely leaks of sensitive information. In light of the Oxbow Carbon decision and similar cases, companies should consider the potential implications if certain shareholders have an information pipeline out of the boardroom. Companies should have clear policies governing when, and with whom, board members may share information they receive as directors, and when they can be excluded from sensitive discussions. And, in some circumstances, as this column recently addressed, boards may want to create a committee of only some directors, at which particularly sensitive issues, such as those involving designated investors, may be discussed.

Oxbow Carbon teaches an important lesson — it is in companies' and investors' best interests to plan ahead how to deal with investor-appointed directors and information rights associated with investor representatives on a corporate board. Companies, counsel, and investors negotiating these issues should consider the balance between the director's fiduciary duties to the company and his or her ability to share with the investor information received in his capacity as a director. And it teaches the important lesson that it is better to prepare for these issues in advance, rather than be surprised by unfriendly investors later. ■

Doug Raymond is a partner in the law firm Drinker Biddle & Reath LLP (www.drinkerbiddle.com).

The author can be contacted at douglas.raymond@dbr.com. Elisabeth Fiordalisi assisted with the preparation of this column.

Directors & Boards

Directors & Boards is the thought leader in corporate governance, written by and for board members.

Individual subscriptions: $325 annually • Full board subscriptions: $2500 annually

Subscribe by phone at **(800) 637-4464, ext. 6072** or online at www.directorsandboards.com