

Considerations in Selecting Special Committee Members

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Whether facing a shareholder demand, considering a large transaction, or launching an internal investigation to uncover and remediate alleged wrongdoing, creating a special committee of the Board of Directors of a company to direct the investigative process can be critical to a successful, independent resolution.

For example, in the context of a derivative action, a thoughtfully constructed special committee allows the board to ensure its fiduciary duties are efficiently discharged and that any demands are addressed to the satisfaction of the court and the company's shareholders. In the context of a corporate transaction, a special committee enables a company to successfully close deals involving possible conflicts of interest. And, when investigating other claims of corporate wrongdoing, a special committee can help protect companies and board members from government inquiries and follow-on litigation.

While there are many factors for a board to consider when determining the right members for a special committee, and the laws vary from jurisdiction to jurisdiction, all special committee members must generally meet two minimum requirements: disinterestedness and independence. While it is clear under these requirements that a company employee who is also a board member cannot be a member of a special committee, the analysis requires the board to do more than simply exclude company employees from consideration.

Even when a director is both disinterested and independent, there are other issues to consider in creating a well-functioning special committee. Taking the experience, skills, and training of various committee members into account can enable boards to

create particularly effective committees who are best able to efficiently review the issues they are formed to assess.

Disinterestedness

Determining whether a special committee member is disinterested is generally less complicated than an analysis of that member's independence. Typically, the resolution of this factor requires only a straightforward evaluation of an individual's involvement in the events under investigation. In other words, potential committee members with a material financial interest in the outcome of the special committee's investigation or who are involved in the conduct or transaction at issue are unlikely to qualify as disinterested.

Independence

In contrast with the comparatively discrete disinterestedness analysis, the question of independence mandates another inquiry. Specifically, while disinterestedness focuses on involvement in the events leading to the special committee's formation, independence entails an examination of the relationships, both personal and financial, between a director and the company. Moreover, the requirements for independence vary widely depending on the circumstances. For example, state law governing director independence in a derivative context may be different than the New York Stock Exchange's listing requirements or some other governing standard. As a result, it is important to consider the various standards that may become relevant, both over the course of the investigation and during any subsequent court proceedings, before selecting special committee members.

Other Practical Considerations

In an increasingly complex and heavily regulated corporate environment, there are many instances in which special skills, training, or experience may make certain directors better choices to serve on a special committee. Although special committees often have the ability to hire experts to support their work, it is still wise to consider the strengths of individual directors when putting together a special committee. For example, industry or legal expertise, an accounting background, or a technical background could all make a director a particularly good fit depending on the investigatory issue at hand.

Finally, the prospective special committee members must have support from the board to discharge their investigatory responsibilities. Investigations often generate unexpected results, sometimes requiring the adoption of challenging or unpopular policies or remediation. Special committee members must command the respect of the

stockholders, board members, company executives, and other constituencies involved in the resolution of pertinent issues. In short, any effective special committee must have secured the trust of all interest holders, especially when the stakes are at their highest.

In today's environment, boards are increasingly called upon to create special committees. To reap the full benefits of the committee, a board must consider both the legal requirements governing the appointment of disinterested and independent committee members and the practical issues influencing the efficiency and effectiveness of the special committee's investigation. By thoughtfully taking these factors into account at the outset, a special committee can represent a powerful option for efficiently managing difficult transactions, litigation, and other compliance and shareholder issues.

Yvette Ostolaza is the managing partner of Sidley Austin's Dallas office, member of the firm's management committee, executive committee, and co-head of Sidley Austin's global litigation practice. She regularly leads complex internal investigations on behalf of companies, board committees and individual directors and defends companies and directors in shareholder and securities class actions. She can be reached at yvette.ostolaza@sidley.com. Paige Montgomery is a commercial disputes and litigation partner in the Dallas office of Sidley Austin. Her practice involves board and committee engagements in internal and government investigations. She can be reached at pmontgomery@sidley.com. Ostolaza and Montgomery are grateful to Daniel Driscoll for his significant assistance in developing this article.

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