Protecting Information to Protect Process – When is it Appropriate to Restrict a Director's Access to Board Records?

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When is a board of directors permitted to withhold information from one of its members? Although Canadian corporate statutes generally grant directors a blanket right to inspect board and committee minutes, courts have denied directors access to information in instances where the materials were sought for reasons collateral to the director's fiduciary obligations, or where the materials were generated in connection with litigation between the director and the corporation (or at a time of known adversity between the two sides).

What is less certain in Canada, however, is the extent to which a board may withhold materials from a director in other situations that present similar governance reasons for denying access to information. For example, may a board withhold from a director minutes prepared in connection with a conflict of interest transaction (such as an M&A transaction in which the director has a special interest) or an internal investigation (of which the director is the subject)?

In such "conflict scenarios," the interested director's access to information may compromise the board's ability to freely investigate and deliberate the matter or to assert privilege on behalf of the corporation. Managing access to information thus becomes an essential governance tool for independent decision-making. For this reason, directors should be mindful of access issues at the outset of any board-led process that requires the management of director conflicts.

Key Takeaways

In this *Governance Insights* article, we discuss the following practices that can assist a board in protecting the confidentiality of, and privilege attaching to, materials prepared in connection with situations that engage director conflicts:

– Establish a special committee of the board that engages and consults confidentially with its own independent legal counsel.

– The committee's mandate should address confidentiality and privilege vis-à-vis the other members of the board.

– The committee should keep its information confidential during the course of its mandate.

– Where possible, the committee should be formed with the knowledge and approval of the full board.

Director Access to Board Records in Canada

Directors have a duty to manage (or supervise the management of) the business and affairs of the corporation, and they are required to exercise care, diligence and skill in doing so. To effectively discharge these responsibilities, directors require access to company records. For this reason, most Canadian corporate statutes grant directors an unconditional right to inspect board minutes. In contrast, board minutes are generally regarded as confidential against the rest of the world (subject to the reach of document discovery in litigation).

Courts have recognized that a director's unfettered right of access to information includes access to legal advice provided to the corporation. Indeed, control over a corporation's privilege in respect of such legal advice resides with the board. As a result, board resolutions purporting to generally restrict a director's access to a company's privileged communications have been struck down as unenforceable.

Yet there are clearly circumstances in which a director's unrestricted access to board materials will not be in the corporation's best interests. Indeed, notwithstanding the blanket inspection right granted to directors under the corporate statutes, courts have denied a director's access to information where it was sought for a purpose collateral to their fiduciary obligations, or where the materials were generated in connection with litigation between the director and the corporation or at a time of sufficient adversity between the two sides.

Given the unconditional statutory inspection right granted to directors, courts have set a high bar for corporations attempting to restrict a director's access to records. This leaves open the question of whether, and how, a board may structure its affairs to limit a conflicted director's access to information in circumstances that do not fit clearly into the collateral purpose and litigation exemptions mentioned above. We provide two hypothetical scenarios to illustrate the issue.

Hypotheticals: No Guidance in Canada

Consider the following fact pattern. A Canadian public company is contemplating a strategic acquisition of a business in which the board chair has a meaningful equity interest. The board established a special committee of independent directors to consider the transaction. Although excluded from the special committee, the chair is curious regarding how negotiations are proceeding and, having overseen numerous acquisitions in her 15-year tenure at the company, asks the committee's lead director if she can review the committee's minutes and provide feedback.

Although the chair's request is believed to be made in good faith, her traditionally outsized role on the board prompts the lead director to consider whether knowledge of the chair's review could influence the committee's ongoing deliberations. The lead director consults with the general counsel to understand the committee's obligations. The general counsel refers to the applicable corporate statute, which provides that board and committee minutes must be open for inspection by all directors.

Consider a different scenario—one in which the board chair receives an anonymous tip alleging that a director has breached the company's code of conduct. After several weeks of investigation conducted by the board and in-house counsel, the impugned director catches wind of the inquiry and requests to see the board's materials and in-house counsel's advice relating to the investigation.

These hypotheticals do not fit neatly into the collateral purpose or litigation/adversity exemptions we previously discussed; the chair's offer to review the special committee's minutes may be made in good faith and the investigation may not enter the zone of litigation or be found to satisfy the requisite level of adversity. Nonetheless, a director's access to information in such scenarios may compromise the board's ability to freely investigate and deliberate or to assert privilege.

Although Canadian jurisprudence does not offer direct guidance to a board faced with the foregoing scenarios, it is worthwhile exploring how a board may set up its governance structure to put itself in a strong position to manage information issues engaged by director conflicts. We start by reviewing how similar issues are addressed in Delaware.

Director Access to Board Records in Delaware

Delaware's corporate statute provides a director with a right to inspect a company's books and records for a purpose reasonably related to their position as a director. As in Canadian corporate law, these rules are animated by the principle that directors are responsible for the management of the corporation and require unfettered access to information in order to effectively discharge their duties. In addition, a Delaware corporation and its directors are regarded as joint clients for the purpose of legal advice furnished to the corporation, with the result that there can be no assertions of confidentiality or privilege between the corporation and a director in respect of materials created during the director's tenure.

Unlike in Canada, however, the Delaware courts have recognized three means by which a board may alter the default rules and successfully assert privilege against a director:

– First, a director's right to privileged information can be restricted by contract, such as a confidentiality agreement.

– Second, the board can form a committee that excludes the director and retains and consults confidentially with its own legal counsel. The special committee must be formed openly, with the knowledge of the excluded director. However, the degree to which such a committee would be required to provide updates to the board and the extent to which a committee can protect its information from non-committee members after its work has been completed have not been substantively considered by the Delaware courts and would likely be fact-dependent.

– Third, a board or committee can withhold privileged information once sufficient adversity exists between the director and the corporation, with the result that the director could no longer have a reasonable expectation of being a client of the board's legal counsel. Examples of "sufficient adversity" have included (i) a director making an offer to purchase the corporation, and (ii) a member of a special committee discovering that the other members were meeting with the committee's counsel without him (the clandestine meetings related to a transaction to which the excluded director's nominating shareholder objected; the court held that the director could access the legal advice prepared up to the point of the discovery of his exclusion).

As noted earlier, some Canadian courts have adopted Delaware's "sufficient adversity" rule, concluding that a director's access to privileged information is "truncated when a director is in an adversarial position to a corporation" and that such adversity will arise when the director ceases to have a reasonable expectation of being a client of the corporation's lawyer.

The Special Committee

Unlike in Delaware, Canadian courts have not opined on the special committee as a mechanism through which a director's access to privileged materials may be restricted. The absence of judicial consideration in Canada, however, should not be reason to conclude that a special committee is not a viable governance tool to protect information.

The use of a special committee to facilitate independent director oversight of a corporate matter is a well-established practice in Canada—one recognized both in Canadian jurisprudence and in the decisions and commentary of securities regulators. Indeed, a board that is considering a transaction in which a director has a conflicting interest will, in many cases, establish a committee of independent directors to consider whether, among other things, the transaction is in the interests of the corporation and minority shareholders. Similarly, a special committee may be established to conduct an independent investigation in respect of a fellow director. Often the committee will refrain from using the company's regular outside legal counsel and engage independent advisers. Although this is intended to ensure the committee is obtaining independent advice, it also potentially limits who may access that advice.

The practice of establishing a special committee that is advised by independent counsel has the clear purpose of facilitating independent consideration of a conflicted transaction or oversight of an investigation; it can also have the added benefit of ensuring that the directors deliberating the matter may avoid any undue influence that could arise from the prospect of having their minutes reviewed by the excluded director during the course of the mandate. Put differently, protecting the confidentiality and privilege of committee materials operates in service of the committee's independent oversight function.

Managing the Special Committee's Materials

With the foregoing in mind, we set out the following suggestions for a board to consider when it is forming a special committee whose deliberations it wishes to remain confidential from the rest of the board.

- **The special committee should be authorized to engage and consult confidentially with its own independent legal counsel.** Directors have access to and control the legal advice that is furnished to the corporation, which will usually include correspondence with in-house counsel and the company's regular counsel. For example, emails between the chair and in-house counsel will ordinarily be accessible by all members of a board. Where a special committee engages its own legal advisers, a different fact pattern is created, one in which the solicitor-client relationship and the flow of communications are intended to be between the committee (not the board at large) and its legal advisers. In certain circumstances, it may be prudent to limit preliminary conversations among the board, management and company counsel (including in-house counsel) until a special committee has been formed and engages its own counsel to carry the mandate forward.

- **The committee's mandate should address confidentiality and privilege vis-à-vis the other members of the board.** The board should approve a written mandate for the committee, setting out its purpose and authority (including its power to retain independent advisers). The mandate should stipulate the board's expectations regarding privilege and confidentiality between the committee and the other directors. In view of the long-standing principle that minutes are the property of the corporation, the scope of the committee's control over its materials must, of course, be carefully constructed with a view to the best interests of the corporation. To that end, the mandate may address the following: the rights of non-committee members to access committee materials during the course of the committee's work; whether and the extent to which the committee is required to periodically update the board during the course of its mandate; whether the committee may control any confidentiality or privilege attaching to its materials, including any decision to disclose or waive privilege and how such decisions will be made; and whether committee members may communicate confidentially with management or regular company counsel regarding the

mandate. Where appropriate, the mandate may specify the extent to which the committee's control over its materials will continue after the committee's work has been completed.

- **The committee should treat its information confidentially during the course of its mandate**. The committee should handle the confidentiality of its materials with care during the course of its work. This means that minutes, materials prepared by its advisers and other committee documents should not be shared outside the committee, absent appropriate arrangements. The committee may need to engage with management and the company's regular counsel. These communications should be carefully considered with the committee's legal counsel to ensure confidentiality is managed and that privilege is not waived.

- **Where possible, the committee should be formed with the knowledge and approval of the full board.** Although this is a Delaware requirement to ensure the special committee may assert privilege against non-committee directors, the rule engages principles that are also relevant in Canadian law. A director will usually have a reasonable expectation that legal advice furnished to the board will be accessible to all members. Where, with the knowledge of the excluded director, a special committee is established and authorized to engage its own counsel, the board is creating a fact pattern that would challenge the reasonableness of a non-committee member's expectations to review the minutes. But this may not always be practical. For example, if a board is investigating one of its members, it may need to act confidentially and without the knowledge of the impugned director. In that case, an argument may be made that where a committee retains its own counsel without the knowledge of non-committee members, the excluded director would not have a reasonable basis to expect to be a client of the committee's counsel.

Internal Investigations: A Deeper Dive

In this article, we briefly touched on intra-board issues of privilege and confidentiality in the context of internal investigations. We will discuss this issue in greater detail in a forthcoming *Governance Insights* article on board-led internal investigations.

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