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The Board's Role in Overseeing Special Investigations

For a number of years, we have cautioned boards of directors to avoid an all-too-common pitfall in crisis management situations: the trap of open-ended, costly investigations that exacerbate rather than alleviate the crisis. The Hewlett-Packard investigation and resignation of its CEO, which has captured headlines for the past week, is one prominent example. These investigations can take on a life of their own and, despite the best intentions, may ultimately cost a company far more than the relatively minor amounts involved in the alleged corporate misconduct. For example, in the Hampshire Group case decided by the Delaware Chancery Court last month, Vice Chancellor Strine opens his decision by saying, "This is an unfortunate case in which it is clear that the parties have spent far more money investigating and litigating over certain matters than those matters involved."

To be sure, if there is credible evidence of a possible violation of law or corporate policy, the allegation should be investigated and appropriate responsive actions should be taken. Depending on the facts, this can include termination of employment and public disclosures. Boards should be mindful of both their fiduciary obligation to exercise oversight and consider "red flags," as well as provisions of the U.S. Sentencing Guidelines that offer reduced penalties to companies that have effective compliance programs and take reasonable steps to respond to misconduct. Boards may also be motivated to conduct investigations due to Section 10A of the Securities Exchange Act, which requires auditors who detect illegal acts to report to the board and, if the auditor concludes that management has failed to take appropriate remedial actions, may require the board to notify the SEC of the auditor's determination.

The board is not, however, required to cede control of the investigation and the determination of appropriate action to forensic accountants, public relations or crisis advisors, outside legal counsel or other persons and organizations that are not subject to the final decision-making authority of the board. As long as the outside directors are not implicated in the apparent misconduct or otherwise tainted by a conflict of interest, they are fully competent to, and should, retain control of the situation and exercise their business judgment as to how the matter should be handled. Even when a regulatory agency or a prosecutor commences an investigation, the board is competent to determine whether to engage counsel to represent the company to defend it, and/or whether to instruct outside advisors to conduct a full investigation and turn their findings over to the investigating authority.

While each crisis is unique, in the absence of a conflict or similar factor, the board is best advised to manage through it as a collegial body working in unison. Experienced advisors can be helpful in assisting the board to gather information and evaluate options, but the board as a whole is responsible for making the key decisions as to what responsive actions, if any, are appropriate and in the best interest of the company and its shareholders in light of all the circumstances.

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