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# Are compliance violation ‘smoking guns’ hiding in the board minutes?

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History has recorded many cases of emails or other written documents that have caused the collapse of organizations big and small. These often unstructured, informal communications help prove cases by showing what board members knew or didn’t know, and when. While Enron provided an example, it’s not only large corporations that have smoking guns hiding<sup>[1]</sup>—every company and organization likely has something hidden away that may surface sooner or later. But with statutory enactments like the Sarbanes–Oxley Act of 2002,<sup>[2]</sup> the U.S. Federal Sentencing Guidelines provisions related to compliance,<sup>[3]</sup> and the widely discussed Department of Justice *Evaluation of Corporate Compliance Programs*,<sup>[4]</sup> virtually no organization can claim to be unaware of the detailed records that must be maintained for compliance purposes. Hidden records can help tell compliance stories, including some that may end with violations, reputation damage, shareholder discontent, or more.

Beyond smoking gun emails, memos, apps, and other corporate documents or database records, there are board meeting minutes. As fundamental corporate records, meeting minutes may not be getting enough attention. For example, shareholder derivative cases highlight the importance of using board minutes to substantiate allegations. Written words recording board discussions and actions may show whether fiduciary duties were fulfilled—or not.

### Board minutes’ many uses

The *Caremark* case sets forth an important standard concerning compliance oversight by which boards continue to be judged.<sup>[5]</sup> The review of board decision-making and knowledge is centered around whether boards sufficiently supervise and monitor organizational operations. Well-designed and efficient compliance functions identify and escalate yellow and red flags for issues needing direct involvement, knowledge, or timely attention by boards. Assurances of reliable systems should indicate that essential information related to risk and compliance matters will escalate in a timely matter for review and consideration.

Documentation—including board agendas and minutes—is a substantial and essential part of compliance in demonstrating whether programs are effective. Minutes, and contents therein, have been produced by shareholders in derivative suits after book and record inspection requests. As legal records of organizational discussions and actions, they may also grab government attention in addition to judicial review. Minutes are also great tools for uncovering information—or the lack thereof—by judges and other governmental agencies.

### Blue Bell’s board minutes

In *Marchand v Barnhill*, a recent example is provided of minutes being used in a shareholder derivative action to

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assess duties of the board.<sup>[6]</sup>

With only one product line, food safety should have been the primary compliance concern of the board. Despite this, Blue Bell Creameries USA Inc. had a listeria outbreak resulting in recalls of ice cream products, pauses of plant operations, worker layoffs, and—most importantly—three deaths and many sickened. Since state and federal regulators found compliance issues between 2009 and 2013 at production plants in three different states, evidence suggests that Blue Bell was aware of warning signs before the 2015 outbreak. Also, the U.S. Food and Drug Administration reported concerns directly to the CEO. Further, the company conducted its own testing, revealing positive tests for listeria on different dates in different plants. Management, however, did not appear to raise these colorful flags up the organizational pole to the board.

Minutes presented from the books-and-records inquiry demonstrated that the board did not record discussions or actions concerning listeria or other product concerns. In the Blue Bell Creameries shareholder derivative suit, allegations included breach of fiduciary duties by intentionally disregarding contamination risks and failing to oversee operations to ensure food safety. The allegations specifically included:

- No committee overseeing food safety, the main corporate compliance concern.
- No board-level process addressing *any* food safety issues.
- No protocols for advising board of food safety reports and developments.
- No policy for advancing to the board known red or yellow flags by management.

The Delaware Supreme Court held that the board failed to implement *any* system to monitor operations or compliance for food safety. In food safety cases, the \$17.5 million fine and forfeiture amount for Blue Bell was the largest-ever criminal penalty at that time.<sup>[7]</sup>

What greatly aided the court in making these determinations? Board minutes. The shareholder's books-and-records request—which included board minutes—showed the lack of good faith efforts for oversight at the board level. Instead of demonstrating that the board made efforts to implement and monitor an oversight system, the board minutes demonstrated that *no efforts* were made by the board to ensure awareness of food safety compliance. Thus, the *Caremark* standard was met by the shareholder bringing this case.

Blue Bell board minutes were part of the records request. If the main corporate product is food (highly regulated for safety), such as in this case, board members should have been asking for information. This board did not appear to have, or even care about getting, any information on product safety, whether good or bad. Here, board responsibility appears to have melted into official or unofficial delegation left entirely to management. The board meeting minutes were key in reaching these conclusions.

## Is sufficient time spent documenting?

On the positive side, carefully crafted and recorded minutes are great tools for demonstrating that a board fulfills its fiduciary duties. It is not uncommon for minutes to be poorly recorded, with examples ranging from full transcriptions and attributions of every word spoken to bare-bones renditions of only motions and votes. Decisions start with making compliance discussions a fixture in boardrooms, thus it should be a focal point to ensure records accurately reflect compliance initiatives and discussions. Showing a good faith effort to maintain detailed records of the conversations held during board meetings begins with a structured plan to collect these accounts.

Agendas are also noteworthy here as well. Commonly, they provide templates for minutes. Compliance matters

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should not be given the final few minutes on agendas or listed as check-the-box “must do” items. Placement and wording choices could be construed as lack of interest in compliance or failure to fulfill board duties. Policies and processes for minutes should be carefully considered and well-designed. Handing agendas or vote totals to someone not in attendance at meetings to produce minutes may get the job done. Boards, however, have ultimate responsibility for adopting minutes. This is a function that is essential to demonstrating reasonable efforts were made to communicate with shareholders and other stakeholders. Board officers must provide appropriate details for each agenda item in order to preserve an accurate corporate record of the meeting.

A survey by the Society of Corporate Compliance and Ethics in 2017 reports 28% of boards do not receive compliance and ethics-related training. This increased to 34% for publicly traded companies.<sup>[8]</sup> Clearly there is room for improvement in the boardroom on compliance and ethics issues. As seen in shareholder derivative cases discussed here, boards should be keenly aware of the importance of board agendas and minutes. Specific training on these legal written corporate records should be part of board education.

## Another shareholder action

In contrast to the *Marchand* case, minutes may be used to conclude appropriateness of board actions as seen in *Towers ex rel. Walt Disney Co. v. Iger*.<sup>[9]</sup>

Shareholders filed a derivative action after learning of potential harm to Disney itself concerning anti-competitive practices. Previously, the Department of Justice reached settlements with allegedly conspiring companies, including Pixar, a wholly owned Disney subsidiary, for unlawful restraints of trade under antitrust laws. Shareholders alleged that Disney participated in the conspiracy. They based their allegations on emails concerning worker recruitment, as well as on meeting minutes during the time of review and consideration of the Pixar acquisition. Interestingly, the court mentions choice of wording in Disney’s 10-K filing, since that document was used as allegation support; the importance of accurate and reliable documentation and disclosure is clear here.

The Ninth Circuit Court reviewed board minutes and determined that the discussion topics were appropriate ones for the Pixar acquisition. Overall, the minutes were not remarkable in the context of the allegations. In fact, the court specifically mentioned an observation by the lower court: failure of the board to discuss such acquisition-related issues, reflected in the minutes, would have been remarkable.

## Capturing the right information

Among the many important elements in these cases, board minutes were key. So what should be included in board minutes and how much? These questions are very important. The answers should involve internal or external legal counsel, given the legal implications for these records. Directors and board officers must have an understanding of the implications of the records they both do and *do not* maintain.

Whether for judges’ eyes in shareholder derivative actions or sought by government agencies for inquiries or investigations, board minutes are legal corporate records. Actions recorded and words chosen to document can be powerful demonstrations of the level of corporate governance in existence—or the lack thereof. Boards should be trained on using agendas and minutes to accurately record and demonstrate fiduciary duties as well as the existence and effectiveness of other compliance and ethics issues, lest those records become smoking guns down the road.

## Takeaways

- Use board minutes as important tools to demonstrate fulfillment of board oversight responsibilities under

Caremark and subsequent cases.

- Recognize the impact of board agendas and minutes to demonstrate compliance and ethics program effectiveness.
- Train board members on the importance of agendas; discussion and action items; and adoption of accurate, reliable board minutes.
- Draft board meeting minutes carefully, involving legal counsel as needed.
- Understand that board meeting minutes may be used by shareholders in derivative actions or by others, including the government.

**1** Rupert Cornwell, “Enron auditor kept ‘smoking gun’ memo,” *The Independent*, February 27, 2014, <https://bit.ly/39IFjDp>.

**2** Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

**3** USSG § 8B2.1 (U.S. Sentencing Comm’n 2018), <https://bit.ly/3ustCbM>.

**4** U.S. Dep’t of Justice, Criminal Div., *Evaluation of Corporate Compliance Programs* (Updated June 2020), <http://bit.ly/2Z2Dp8R>.

**5** *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

**6** *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

**7** Department of Justice, “Blue Bell Creameries Ordered to Pay \$17.25 Million in Criminal Penalties in Connection with 2015 Listeria Contamination,” news release, September 17, 2020, <https://bit.ly/3czyENK>.

**8** Society of Corporate Compliance and Ethics & Health Care Compliance Association, *Compliance Training and the Board*, September 2017, <https://bit.ly/39r3ZQN>.

**9** *Towers ex rel. Walt Disney Co. v Iger*, 912 F.3d 523 (9<sup>th</sup> Cir. 2018).

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