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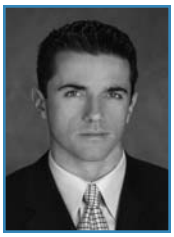
Corporate Update

SB1306 and Corporate Communications



Glenn Truitt

California has adopted legislation which changes how companies can use electronic communications in their "corporate communications." The changes broaden the options available to corporations for conducting many of their required communications, such as meetings of boards of directors, shareholder meetings, delivering notices of meetings, taking actions without a meeting and annual reports. In most cases, corporations will have to take affirmative action to take advantage of these new rules. While these new rules may provide some advantages, companies should consider carefully the nature of these new methods of corporate communications before adopting them, since it may not always be in their best interests.

SB1306 was signed into law in August of 2004 and amends a variety of provisions in the California Corporations Code. The Bill added two new defined terms to the Corporations Code: *electronic transmission to the corporation* and *electronic transmission by the corporation*. The bill also amended the definition of "writing" to now include these two terms which, due to the extensive use of the word "writing" elsewhere, made their application nearly universal to the code.

Electronic Transmission by/to the Corporation

"Electronic transmissions by the corporation" allow a corporation to communicate with shareholders, directors and other recipients by: (a) fax or electronic mail directed to the fax or e-mail address on record with the corporation for that recipient; (b) posting on an electronic message board or network that the corporation has designated for those communications, with separate notice to the recipient of the posting; or (c) other means of electronic communication. There are, however, key additional requirements to effect a

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A Practical Approach To Creating And Implementing A Records Retention Plan

Dan P. Sedor

The Problem—The Information Explosion Meets Electronic Discovery

The explosion in the amount of electronic business records, now nearly 20 trillion documents a year, is a byproduct of technology-driven gains in productivity. Unfortunately, the way these proliferating records are often mishandled is a disaster waiting to happen. E-mail is now the majority of evidence in litigation, but a recent survey of corporate counsel showed that 59% of surveyed companies lack e-mail retention policies and 62% doubt their electronic records are accurate and reliable. Courts are setting high standards for the retention and production of electronic records in litigation, and imposing crippling sanctions for failures to meet them. Last years $1.45 billion verdict against financial giant Morgan Stanley, a result of its inability to preserve and produce e-mails and its efforts to conceal those shortcomings, is only one example.

The possibility of punishment is just one downside to not having a comprehensive records retention plan well in advance of litigation. Even if a business is lucky enough to avoid sanctions, the expense of electronic discovery when records are too voluminous or in disarray can be so prohibitive that it becomes pivotal in determining whether to litigate at all.

Litigation is not the only reason businesses need better control over recordkeeping. Knowledge of and control over business records is essential for companies subject to regulatory records retention requirements, including SEC and IRS rules and the Sarbanes-Oxley Act. It also happens to increase efficiency and reduce costs.

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communication by these methods: (1) the recipient must have provided an unrevoked consent to the use of such communications; (2) if the recipient is a shareholder and an individual the transmission must also meet the "E-Sign requirements;" and (3) the communication must create a record that is capable of retention, retrieval and review. "Electronic transmissions to the corporation" are defined almost identically to transmissions by the corporation, except that in the instance where an electronic message board is used, no separate notice is required and the corporation must have reasonable measures in effect to verify that the sender of such a transmission is the shareholder or director that they purport to be.

Meetings and Notice, Board of Directors

SB 1306 makes clear that meetings of directors can be noticed by electronic transmission by the corporation, and is ultimately more restrictive than the previous version of AB 699, since the previous statute did not have the E-sign requirements attached. The Corporations Code permits a corporation to vary a number of statutory provisions, including requirements for notice of meetings, but not to eliminate the requirement that special meetings of the directors must be preceded by minimum notice. As a result, existing bylaw provisions for notice by electronic means remain effective, but will not allow the corporation to automatically avail themselves of the provisions of SB 1306 without specific amendment thereto.

With regard to directors' meetings, California law has allowed directors to meet via "electronic video screen communication" since 1995, and has allowed directors to meet by conference telephone for more than thirty years, and SB 1306 continues to relax the requirements surrounding video-conference and conference telephone. SB 1306 explicitly allows for Board meetings to take place via electronic transmission by and to the corporation, but adds that: each director must be able to communicate with the other members concurrently, including (i) the means to participate in all matters before the Board and (ii) the capacity to propose, or interpose an objection to, a specific action to be taken by the corporation. In the case of meetings of the Board, a failure to specifically amend the bylaws to allow the corporation to avail themselves of the new changes will nonetheless leave both the pre SB 1306 and the SB 1306 restrictions in place; this can result in a set of rules which are too stringent and also prevent the corporation and the Board to take advantage of new methods of communication, which would be available under the new definitions.

Meetings and Notice of Shareholders

SB 1306 amends Section 601(a) of the Corporations Code so that notice of a shareholder meeting must specify the means of electronic transmission if shareholders are to participate by such means. Under SB 1306, notice can also be given by electronic transmission by the corporation, provided that the corporation has delivered notice by that method on two consecutive attempts, unless the corporate secretary, or other person designated to give notice, becomes aware that notice has not been given.

A key change made by SB 1306 is the ability to hold shareholder meetings both via "electronic video screen communication" and electronic transmission by and to the corporation. That authority is subject to a number of cautionary restrictions. First, the corporation must implement reasonable measures to provide shareholders (in person or by proxy) an opportunity to participate in the meeting and to vote on matters submitted to them, including an opportunity to read or hear the proceedings of the meeting concurrently with the those proceedings. Second, if any shareholder votes or takes other action at the meeting by means of electronic transmission to the corporation or electronic video screen communication, a record of that vote or action must be maintained.

In adopting SB 1306, the legislature also addressed the concern that some shareholders would not have the requisite technology to participate in such meetings, and included in the statute a requirement that the corporation hold the meeting at a physical location if any individual shareholder does not consent to meet by electronic means. Any request for consent must notify the shareholders of this option. SB 1306 also imposes specific limitations on shareholder presence that is other than in person or by proxy (i.e., by video conference, including: (i) the Board, in their sole discretion, authorizing such a presence, and (ii) that presence being subject to the guidelines and procedures, if any, adopted by the Board.

Unlike Cal. Corp C. § 307, the requirements of Corporations Code 600, as now amended, cannot generally be varied by articles and bylaws. A corporation's bylaws can however, prohibit shareholder attendance other than in person or by proxy. Ultimately, corporations should consider conforming their bylaws to the new provisions of SB 1306 if the corporation anticipates shareholder participation by electronic transmission by and to the corporation.

SB 1306 now permits the delivery of annual reports by electronic transmission if approved by the Board of Directors . . .

Actions Without a Meeting

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The explosion in the amount of electronic business records ... is a byproduct of technology-driven gains in productivity.

The Solution—Practical Pre-Litigation Records Retention Planning

To help avoid sanctions, reduce electronic discovery expenses and get recordkeeping under control, more businesses are not waiting for litigation to deal with electronic discovery. They are formulating and putting into place records retention plans well prior to even the threat of litigation. This new proactive approach acknowledges three simple but immutable facts:

- Litigation is inevitable
- It will involve electronic discovery
- Compliance will be mandatory

Records retention planning for litigation not yet on the horizon may seem to be a project without goals or limits. The key to success is designing and following through on a flexible and realistic plan that takes into account legal requirements and the needs of the business.

Step 1—Assemble a Team

Begin by identifying the people who will be responsible for designing the records retention plan and who are responsible for the records covered by it. The size and makeup of the team will depend on the size and diversity of the business. Any business unit that generates a significant amount of electronic or hard copy records should be considered for representation, especially those likely to be involved in litigation, including legal, finance and accounting, sales and marketing, human resources, executives and managers and, of course, information technology. Overall responsibility for the plan should be assigned to legal officers.

Outside counsel knowledgeable about electronic discovery and records retention requirements can help identify appropriate team members and formulate the plan. An outside technical consultant should also be considered, particularly if IT personnel are relatively unsophisticated in recordkeeping regulations or electronic discovery duties. For example, recent decisions have required production of metadata associated with electronic files. Moving or copying such files without following accepted procedures to ensure integrity and a proper document trail can result in prohibited modifications. A consultant may also help to identify technical flaws in how a records retention plan is being implemented, such as user or system profiles that allow overwriting of e-mails the business intends to retain.

The possibility of punishment is just one downside to not having a comprehensive records retention plan well in advance of litigation.

Step 2—Create a Schedule

As with most projects, a records retention plan without an implementation schedule is just that—a plan. The team should prescribe a firm and realistic schedule for meeting each of the milestones in their plan. The schedule should give sufficient time for implementation, evaluation of results and any adjustments that need to be made, but should be short enough to convey the importance of the project. Litigation will not wait. As the project progresses, the team should consider periodic e-mail schedule reminders that note upcoming milestones.

Step 3—Assess What You Have

Next, the team members should catalog the records created and maintained by the business, by business unit if appropriate, and the various types of electronic media on which they are maintained, including servers, desktop and notebook computers, portable drives and PDAs. The devil here is in the details. Matters as mundane as the number, location and contents of file cabinets should be considered, to allow as comprehensive a records assessment as possible. A helpful tool is a report detailing the nature, type and location of the records being assessed.

. . . each step in the records retention planning and implementation process should be documented by the retentions team.

Step 4—Determine What To Keep and Why

Once the records are catalogued, the team members need to come up with a practical rationale for determining which records to retain and for how long. This is the core of the plan. Each category of records should be analyzed in light of the goals of the business and a decision made as to whether the business needs, on an ongoing basis, to maintain those records. As the widely cited Sedona Conference Working Group on Best Practices for Electronic Document Retention and Production has noted, no single standard can meet each organizations unique needs. A helpful question to ask is whether there is a current business, legal or regulatory need or requirement for the retention of a particular category of records. If the answer is no, consideration should be given to disposing of the records, particularly if retaining them carries a substantial cost. If the answer is yes, the question becomes one of duration. Applicable regulations may spell out retention periods. Contracts and related documents may need to be analyzed in light of potentially applicable statutes of limitation. In addition, the records retention

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A key change made by SB 1306 is the ability to hold shareholder meetings via "electronic video screen communication" and electronic transmission by and to the corporation.

SB 1306 did not directly amend Cal. Corp C. § 307(b), which authorizes corporate action by unanimous written consent. However, by expanding the definition of "writing," the bill effectively authorizes directors to take such action by electronic communications to the corporation. For shareholders, the same general scheme applies.

Annual Reports and Other Forms

SB 1306 now permits the delivery of annual reports by electronic transmission if approved by the Board of Directors, but articles or bylaws can still require physical delivery. It is important to note that while this summary addresses corporate forms, California concurrently made similar amendments to laws governing partnerships and limited liability companies that are nearly identical in form and function.

Actions Going Forward

While the changes made by SB 1306 are relatively simple, taking advantage of the legislation will require that an entity reconsider its articles of incorporation and bylaws. Before making those changes, corporations, whether publicly traded or privately held, have to consider some of the unanswered questions in the statute.

For one, while it is not clear exactly what sort of "communications" were envisioned by lawmakers, the modern-day instant messenger or chat room type applications could certainly qualify. Because these forms of communication are difficult, if not impossible, to secure, many entities may choose to avoid electronic communications. In addition, as differentiated from corporate "minutes," an electronic record will be verbatim and does not lend itself to the brevity and directness of a written record—statements made at a meeting will automatically become part of a record, whether they are completely considered or not. It may prove functionally impossible to eliminate anything from such a record, even with the requisite consent from the present members. If the sensitivity of discussion normally involved in the directors' meetings would necessarily chill discussion if such a system were introduced, it may be in the company's best interest to avoid updating its bylaws.

The omission of a mandatory inclusion of the new provisions in formation documents of California corporations (and other business entities) should not be presumed to be accidental. It is meant to be elective. While there are clearly logistical advantages to allowing directors and shareholders to participate in meetings and be notified of them electronically (namely saving costs on travel, mailings, etc.), implementation of such a system is likely to have a high entry cost, and the disadvantages provided may ultimately outweigh any convenience

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Corporate Counsel Roundtables

Scott Brink, a partner in JMBM's Labor & Employment Group presented "Drafting Better Agreements with Executives and Other Employees" on November 15, 2006 to the participants of JMBM's Corporate Counsel Roundtable, hosted by Bill Capps.

Bill Capps along with **Stan Gibson, Michael Gold and Dan Sedor** of JMBM's Discovery Technology Group™ presented a program titled "Steps You Need To Take Before December 1, 2006 To Protect Against E-Discovery." The program was presented at the JMBM Corporate Counsel Roundtable on September 6, 2006. For more information about e-discovery, please visit JMBM.com/dtg.

Bill Capps hosted a Corporate Counsel Roundtable session on June 21, 2006, in which in-house counsel discussed techniques which inside counsel have found effective in working with their outside counsel to obtain better and more efficient results. The topic was "Working Smarter With Your Outside Counsel."

Bill Capps and **Timothy S. Barker,** Managing Partner of the Los Angeles office of the world's leading corporate immigration law firm, Fragomen, Del Rey, Bernsen & Loewy, LLP, presented a Corporate Counsel Roundtable on April 26, 2006 titled "What You Want to Know About Immigration Law for Your Company." Mr. Barker is an active member of the American Immigration Lawyers Association and a frequent lecturer on immigration law. He has written numerous articles on business immigration law matters for major publications.

Articles and Handouts: We have limited copies of JMBM Corporate Counsel Roundtable presentation materials. If you would like to request a copy, please contact Bill Capps (310.201.3513 or wcapps@jmbm.com). To register for an event, please contact Jeremy Braulick (310.712.6828 or jbraulick@jmbm.com).

(Records Retention Plan... continued from page 3)

team should consider the relative benefits of a single, uniform retention period or differing, category-specific retention periods.

Step 5—Implement the Plan

With a schedule and plan in place, the next step is implementation. IT personnel should implement the plan on enterprise-wide systems such as databases and e-mail servers and follow up with ongoing compliance monitoring. The plan will also need to be implemented as to records maintained by individual business units and employees. Since this will require employee cooperation, the requirements for compliance should be distributed and reinforced, and periodic training courses on compliance should be considered. Methods of further encouraging compliance, such as employee incentives, limits on available electronic and physical space for employee or business unit and spot checks of compliance by IT and administrative personnel, should also be considered.

Step 6—Institute a Litigation Hold Procedure

The possibility of punishment is just one downside to not having a comprehensive records retention plan well in advance of litigation.

Many recent cases, including the well-known *Zubulake* decisions, stress that businesses must suspend ordinary procedures for the disposal of records, including e-mails and backup tapes, once there is reason to believe they are relevant to potential litigation. For this reason, and because a failure to heed that warning can have disastrous consequences, a comprehensive litigation hold procedure should be part of the records retention plan. This procedure is typically the responsibility of a legal department or officer. The business should consider advising employees periodically that in the event a litigation hold notice issues, they must maintain the records identified in the notice until advised otherwise.

A form of litigation hold notice that can be modified as necessary in the event of litigation should be designed. When litigation is on the horizon, the responsible officer or department should issue the notice and send out periodic reminders of the litigation hold requirements. Compliance should also be monitored.

Step 7—Document the Plan

One lesson of the recent decisions sanctioning businesses for inadequate records retention procedures is that good faith efforts to comply with electronic discovery and recordkeeping requirements can be an important factor. For this reason, each step in the records retention planning and implementation process should be documented by the records retention team. This information may need to be submitted to a court to show that the business undertook reasonable efforts to design and put in place a plan intended to comply with legal requirements.

Step 8—Reevaluate Regularly

The key to success is designing and following through on a flexible and realistic plan that takes into account legal requirements and the needs of the business.

All businesses evolve. Employee turnover and corporate restructuring are facts of life. Accordingly, each business should periodically confirm that its business units are still appropriately represented on its records retention team, and the team should periodically reassess whether their plan remains current and effective and covers all appropriate records. If necessary, the plan should be modified to cover new operations or changes in infrastructure. Throughout, the plan should continue to be simple, straightforward and flexible. Keeping these goals in mind will make your records retention plan an effective tool for electronic discovery compliance in the future. ■

For more information on creating and implementing a records retention plan, contact **Dan P. Sedor** (310.785.3554; DSedor@jmbm.com).

JMBM Welcomes

Dawn Horrocks to the Corporate Group

Dawn Horrocks is a business lawyer who practices in the areas of corporate, investment management and securities law. She has experience representing financial institutions, institutional investors and other business entities in connection with a variety of corporate finance transactional matters, including mergers and acquisitions, private placements of securities, venture capital, investment partnerships and other general corporate matters. Dawn also has experience in regulatory and transactional matters relating to the investment management industry. She has represented private equity, hedge and venture fund sponsors in connection with fund formation and organizational matters. Dawn has also represented several investment advisers in connection with restructurings and mergers and acquisitions. Dawn can be reached at 310.201.3511or DHorrocks@jmbm.com.

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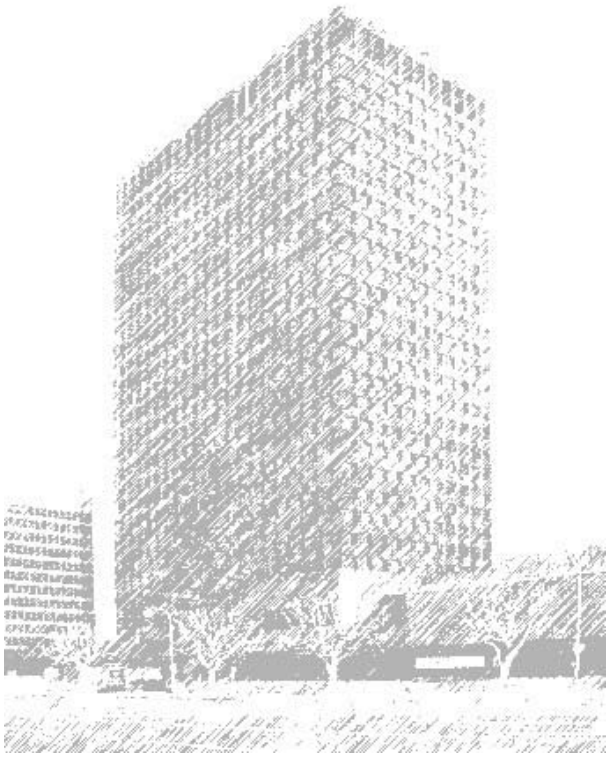
gained. It would appear that the best approach with new and existing clients would be to, based on knowledge of the entity and their operations and goals, inform them of the costs and benefits of implementing the new provisions and allow them to make an intelligent decision on whether or not to avail themselves of SB 1306. ■

[1] The Electronic Signatures in Global and National Commerce Act (15 U.S.C. §§ 7001-7006) requires the shareholder be provided with a "clear and conspicuous state-ment" informing the shareholder: (i) the right to receive the transmission in non-electronic form; (2) the right to withdraw consent (3) whether the consent applies only to the individual transaction or to categories of transactions; (4) the procedures to withdraw consent; and (5) how, after consent, the shareholder may request a paper copy. In addition, before consenting the shareholder must be provided with a state-ment of the hardware and software requirements to access the electronic trans-mission and the shareholder must consent (or confirm consent) in a manner that reasonably demonstrates the shareholder can access the information in electronic form.

For more information concerning SB 1306, contact **Robert Braun** (310-785-5331; RBraun@jmbm.com) or **Glenn Truitt** (310-785-5386; GTruitt@jmbm.com).



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