Inside the Minds:
Corporate Governance Law

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An attorney who specializes in corporate governance represents companies, including directors and officers, as well as investors on the most important issues concerning the relationship between the shareholders who own the stock of the corporation and the managers who are responsible for the company's affairs and operations. Corporate governance enters into every aspect of the corporation, including the corporate decision-making process on the most fundamental issues facing a company such as mergers and acquisitions, as well as the relationship between management, the board and all of the company's other constituencies. My role bridges the divide between corporate law and litigation, since I generally advise boards and investors on their fiduciary obligations with respect to a wide range of corporate transactions and decisions, and also represent these entities in litigation on these issues.

Components of Corporate Governance

Corporate governance law goes to the heart of how a corporation operates, and is really at the core of the corporation. Thus the more traditional areas of corporate law, such as mergers and acquisitions, litigation, intellectual property and other key decisions made by the corporation are all under the corporate governance umbrella. This is because corporate governance focuses on the decision-making process for directors and officers on the most important issues facing the corporation, as well as the relationship between these entities and shareholders.

More generally whenever a corporation is making a critical decision the process by which it reaches that decision—what information it considers, how long it deliberates and who is involved in the decision-making process—are all issues at the core of corporate governance. A corporate governance lawyer needs to be both expert in particular areas and have sufficiently broad knowledge on a variety of issues that s/he can determine whether or not the company is receiving adequate information in areas where s/he is not an expert. In addition, the corporate governance lawyer is the counselor and adviser to the leaders of the corporation, including advising these leaders on what types of additional information they should have to make an informed decision, and who should be involved in that process.

Helping Clients

A corporate governance lawyer adds the most value for a client by bringing his/her judgment to bear on what is the most appropriate decision-making process for a particular decision. I try to help my clients understand how their decisions, and the decision-making process that is employed, are going to look to a lawyer and/or jury, while trying to help a judge or jury understand what the board was facing when it made its decision and why it chose the path it chose. I am not a business person, and I cannot make the business decisions which are at the heart of what boards, officers and investors do; what I can do is help each of those groups have adequate information and deliberation so that they can reach a decision that they are comfortable with after the fact, and also try and create as transparent a process as possible so that each of the other corporate constituencies understands how and why a particular decision was made.

More generally, I am trying to help clients achieve three objectives. First, I try and help the client achieve its business objective in the face of legal challenges and considerable scrutiny. Second, since I am generally only called in when a situation is of critical importance to the company, I am trying to make sure that whoever is considering the available alternatives has the requisite time, information, and ability to come to a decision that he/she will still feel comfortable with and support, even in hindsight, given all of the circumstances. Finally, since I frequently represent the corporation or another entity with fiduciary duties, I try and keep the broader ethical and moral agenda before the decision-makers at a time when there may be a temptation to take a more expedient decision or to put such concerns lower than where they ought to be.

The two primary types of clients I work with are: (i) companies, broadly defined, to include the board of directors and all "C-level" officers; and (ii) shareholders, institutional investors, and other governance advocates. These groups have a tendency to view the other as adversaries, and frequently a big part of my job is trying to make each group understand how the other looks at a particular issue. As a general matter, the first group tends to look at corporate issues through a wider lens, considering the broader corporate constituencies (*i.e.*, employees, customers, suppliers, in addition to shareholders) while the second group is more focused on shareholder interests and shareholder value. This is particularly true when I get involved in a situation, as often by that time there has been some type of communication breakdown or apparent conflict between the interests of shareholders and the interests of the other corporate constituencies. As a result, while often I am called upon to discuss governance issues in the context of shareholder value, I have found that focusing exclusively on shareholder value can lead to a fundamental changes to the corporation (*i.e.*, a sale, merger, change of control or other significant situation involving the scope of a director's fiduciary duties) which have enormous corporate governance implications.

Many of these situations and decisions also are eventually challenged in litigation. These lawsuits are often brought by shareholders, who challenge decisions by directors and/or officers, as well as the decision-making process employed by these entities. Facing this fact, directors or shareholders should go into any situation knowing there is a significant likelihood of litigation and planning for the same. This does not mean that they are prohibited from taking action that they believe necessary and appropriate. Rather, it just means that they should be aware of how these actions are going to look to an outsider viewing the situation dispassionately. I call this the "*Wall Street Journal* Test" – that is, a director or shareholder should only take action, and only following a process, that they would be comfortable seeing as the subject of a page one story on *The Wall Street Journal*.

My primary value to my clients is to provide them with judgment and experience. They come to me in very difficult situations which often require expedited decisions and when they are facing a great deal of pressure and public scrutiny. Further, the risks are often great, not just for public embarrassment but for the types of damages and risks that exist in our legal system. While I have particular areas of expertise in the law (I chair my firm's M&A Litigation Department and have considerable experience litigating a variety of issues involving director and officer liability in the Delaware courts and throughout the country), what my clients really want from me is an unbiased and experienced view about how to look at a particularly difficult situation and what issues are likely to be important to courts and investors when they look at the situation in hindsight.

The other primary value I provide to clients is to make sure that they have sufficient time and information to make a decision that they honestly believe to be in the best interests of the entities they serve. The decision may not be perfect, but it is one that they reasonably believe to be the best they could do under the circumstances. For example, I represented Hewlett-Packard in connection with its merger with Compaq and in its subsequent proxy contest to gain approval for that transaction, as well as in the litigation brought by Walter Hewlett challenging the shareholder vote approving the merger.

While there has been, and remains, considerable debate about some of the business decisions involved in that transaction, the fact remains that the decision-making process by the board as well as the company's conduct in the proxy contest was found to be beyond reproach despite being put under the closest scrutiny of perhaps any corporate governance action in recent years. More generally, I like to think that I allow a director or investor to focus on issues that really matter and give these issues quality time and thought, without undue concern about extraneous issues (including litigation).

Common Mistakes

The biggest mistake that clients often make is trying to figure out if there is any real value in corporate governance. Far too often corporate governance has been portrayed as solely a process issue, without substance and designed to protect directors in nuisance litigation. In reality, corporate governance is a tool which allows the corporation's leaders to have the information and time to make the best decisions possible, as well as a framework which allows the corporation to operate in an ethical manner and provide transparency to all of its constituencies about how decisions were made. Thus a well governed company gives its investors, employees, customers and other constituencies confidence that it is making decisions are solely in the best interests of the various corporate constituencies, and are being done on an informed basis and with due care.

In part the somewhat cavalier attitude about corporate governance has been fostered in recent years by the various “metrics” that have been created to “monitor” a company’s corporate governance. These metrics can lead to a “check the box” mentality among some. In addition, in response to some of the corporate governance scandals over the last few years there has been a tremendous effort to “reform” corporate governance in American corporations, but again some of the attention to this issue has led to a multitude of “one-size-fits-all” governance standards, which may be proper as a general matter but may not make sense in particular situations. For example, we now have a situation where it is common to only have one “inside” director on a public company’s board of directors, with all of the other “outside” directors having no affiliation with the company other than through their work as directors. This may be appropriate under particular circumstances, but it may also lead to a situation where the board’s ability to help pick and guide the company’s strategic direction is too limited because the board lacks the relevant company experience.

More generally, corporate governance is an evolutionary process, and what once may have made sense may no longer work, while new procedures are continually being developed. For example, historically corporate directors have been elected by a plurality vote, such that even if a director received a minority of the outstanding shares (or even the shares voted) he kept his seat so long as no opposing candidate received more votes. Currently, however, this system is the subject of significant debate, and companies such as Pfizer have taken the position that directors must be approved by a majority of shareholders, even if they are not in a contested election. Similarly, where 25 years ago many companies had a majority (or at least a significant number) of inside directors, today most companies have no more than one or two such directors. Again, however, these types of evolutionary developments may be better left to the market as when such decisions are made by the corporation it provides tremendous benefits to all corporate constituencies by giving confidence to these constituencies that the Company is well governed.

Remaining Relevant and Innovative

There are so many changes occurring in the legal landscape surrounding governance issues that we make tremendous efforts to keep clients up to date. For example, we send out regular bulletins to clients about new cases or developments, we hold special sessions for our clients where our firm advises them on recent developments, and I regularly speak and teach at various forums on governance issues. I have repeatedly been a member of the faculty at the Duke Directors’ College, have also taught at the Stanford Directors’ College, and frequently give lectures and presentations on a variety of governance related issues to other lawyers and business people.

I work and read all the time to stay on top of my game. There are so many new developments and sources of information that it is a continual challenge to stay on top of it all. At the same time, it is both exhilarating to work in this area and technology has made it ever more possible to access new sources of information on a real-time basis.

Experience creates innovation. The more you learn on this job, and the more experience you are able to bring to a situation, the more you are able to take a novel position and be comfortable with such a decision. The facts of particular situations are always changing and the role of the corporate governance advisor is to be able to provide a framework or structure whereby the important objectives can be achieved or the reasons why they cannot be achieved can be understood so that other options can be examined.

Changes in Corporate Governance

Corporate governance law is constantly changing, not just because of statutory law (although there have been tremendous changes in the statutory landscape over the last few years), but also because of the involvement of the courts, regulators, and self-regulatory agencies. For example, many of the most significant governance changes in recent years occurred because of amendments to the various listing requirements of the New York Stock Exchange and NASDAQ. Indeed, the NYSE's continued emphasis on corporate governance (a role consistent with its historic practice) has led this self-regulatory body which is the symbol of Wall Street to take stronger and more direct actions on corporate governance such that it is now one of the world's leading voices on all corporate governance issues.

Another leading source for corporate governance is the Court of Chancery in Delaware. The judges in this court see many of the most complex business and governance issues on a regular basis, and have spoken widely on various critical governance issues, not just in their opinions but also to the broader business community in various speeches and articles. Separately, in recent years we have seen a number of non-traditional institutions become involved in the corporate governance debate. For example, union pension funds have played a very significant role in the area of executive compensation, bringing this issue to the forefront in a number of companies and highlighting the growing disparity between executive pay and the pay of the average worker. The increasing power of institutional investors, who are estimated to own more than 50% of all U.S. equities, has also had a dramatic impact on corporate governance as these investors increasingly demand that boards be responsive to their demands or face their wrath when it comes time to seek a shareholder vote. Thus, if one is looking for just new laws on a statutory basis, this is far too narrow a search. Rather, the corporate governance landscape is continually changing and evolving as a result of new players becoming involved and a desire by all for greater transparency into the corporate decision-making process.

All of these developments mean that changes in the corporate governance landscape are likely to continue. This is true for many reasons, including the fact that corporate governance is becoming a global force. Already, many of the institutional investors that played such a large role in changing the way U.S. companies are governed are investing globally, and are demanding greater transparency and input into the governance process in other countries. At the same time, foreign companies continue to play an ever important role in the U.S. economy and attempt to access the U.S. capital markets, bringing their corporate governance methods and traditions to this country. In addition to the globalization of governance, the spread of technology, which makes it easier to communicate and allows for easier processing of information, will have a huge impact on corporate governance. This is because all of the company's constituencies will increasingly demand that the company's decisions, and decision-making process, be transparent, done on a "real-time" basis, and improved to incorporate these changes.

Finally, I would urge all of the company's constituencies to embrace these changes and developments in corporate governance. Again, corporate governance should not be viewed as a separate part of the company, to be handled in separate discussions between competing interest groups; rather, corporate governance is the umbrella under which the company defines its relationships with all of its core constituencies, and decides how it is going to obtain the information necessary to make the most important decisions to the corporation.

A FOCUS ON PERSONAL LIABILITY FOR CORPORATE EXECUTIVES

An executive in today's world is not going to stay clear of corporate governance issues, nor should s/he try. Rather, s/he should embrace the fact that corporate governance issues are here to stay, and figure out how to obtain the benefits from implementing the best corporate governance practices, including figuring out how to find the strongest directors, how to ensure that the board has the right amount of information to act on an informed basis and the proper amount of time to go over that information and provide the best guidance to management, and how to act proactively with all of the company's core constituencies so that a crisis can be averted before it starts.

Course of Action

The best way for executives to prevent themselves from ever being personally liable for corporate governance issues is easy (at least in theory). Directors that put in the time, pay attention, focus on the real issues and act in what they honestly believe to be in the best interest of the company and its shareholders as opposed to their own personal interest are very unlikely to be held personally liable for any decision.

Proper documentation for the reasons and decision-making process is obviously very helpful, and of course is another area where I would typically get involved. Thus my role includes making sure that documents such as minutes, board presentations by lawyers and bankers, and other evidence supporting and demonstrating the deliberative process behind decisions are both part of the record and properly maintained. In addition, part of my job is to make sure that the board has sufficient time to consider the information that it is provided, as well as to ensure that the board has access to any other appropriate experts which may help its deliberative process.

Executives should understand the documents they sign, such as financial statements, are considered very serious. Before signing off, they need to know the process by which the results set forth in the documents were achieved. Again, like any other important decision an executive is asked to approve, an executive asked to sign off on an important corporate document should be prepared to demonstrate why he/she felt comfortable signing the document.

There are no specific "checklist" items executives should make sure of to limit their personal exposure; indeed, searching for such a list is often an invitation for trouble. Rather, each situation must be evaluated independently and the amount of attention and the process a situation deserves depends on the importance of the matter. Again, however, this is where the corporate governance adviser plays a key role, as a major part of their job is to ensure that an executive is aware of the types of issues that s/he should consider before approving or signing off on critical decisions.

How Cases Arise

Corporate governance cases come about any time a corporation engages in any significant transaction or action. The reality is that in today's environment virtually any significant event in the life of the corporation may be fodder for litigation.

How a case proceeds varies depending on the issue(s) involved. For example, I have been involved in several situations where the corporate decision led to highly expedited trials, including full trials on the merits only weeks after the decision and filing of the case (in contrast to most other cases, which often take years between the time of initial filing until the trial is finally heard). Because these types of cases can be heard on such an expedited schedule it is most critical that the process prior to the actual decision which is the subject of the lawsuit be a strong one, for almost inevitably the challenge is both to the decision and to the process by which the decision was made.

Alternatively, cases challenging corporate decisions and/or the decision-making process can last for years, particularly where the claims involve alleged violations of the federal securities laws, or claims for breaches arising out of products' liability or patent infringement matters. Under these circumstances the need for a well documented record becomes especially important, as often memories fade and reasons why (and how) decisions were made can only be shown through contemporaneous documents as opposed to the recollections of the persons involved.

Defense Strategies

If I were sitting with a company executive who was just told they were being taken to court over a corporate governance case, my first hope would be that the first time I was sitting with this executive was *before*, not after the case was filed. Indeed, by the time the litigation has been filed many of the most difficult decisions have already been made. The includes such decisions as what types of information the executive had before him/her when s/he made the decision, who provided that information, and how long the executive had to consider the information that was provided. All of these issues are critical in any litigation challenging the decision which was made.

However, assuming that the first time I met the executive was after the case had been filed, I would try and understand the business situation and realities facing the executive at the time they made the decision and the reasons for that decision. Courts and juries are generally receptive to legitimate business decisions by executives and understand that some of these decisions will be difficult and eventually may even be questioned in hindsight. However, so long as the decision was made in good faith, following reasonable deliberation and in the best interests of the corporation and its various constituencies as opposed to any self-interest on the part of the executive, there is an excellent chance that I will be able to explain the executive's decision and decision-making process to such that s/he will not be second-guessed by the court or a jury. At the same time, however, explaining that decision requires a complete understanding of the reasons and circumstances supporting and surrounding the decision-making process.

Damages

The amount of damages normally sought varies greatly depending on the situation. For example, Citigroup recently settled its Enron cases for $2 billion and the stories about individual director payments in Enron and WorldCom were well reported. Other corporate governance failures, such as Healthsouth, Tyco, and others, may result in jail time for various officers and/or directors. But one cannot be that surprised by these results; the reality is that wherever real fraud occurs all of the penalties for such behavior are available and appropriate. The real question is whether this is a "corporate governance" failure per se, or some other type of personal failure that should not be blamed on corporate governance.