

WSGR ALERT

DECEMBER 2011

CRITICAL ISSUES FOR BOARDS OF DIRECTORS: A PERSPECTIVE FROM WILSON SONSONI GOODRICH & ROSATI

At a recent conference, Wilson Sonsini Goodrich & Rosati CEO Steven Bochner and Chancellor William Chandler,¹ a partner at the firm, discussed developments in corporate governance over the last decade, as well as critical issues facing boards of directors going forward.

Three Themes in Corporate Governance

The last decade has seen the emergence of three key themes in corporate governance:

- **Entrance of new actors.** While corporate governance historically has been the almost exclusive province of states, over the last decade the federal government, Securities and Exchange Commission, stock exchanges, and proxy advisory firms each have become more involved in standard setting.
- **Transfer of power from management to boards.** Federal legislation, such as the Sarbanes-Oxley Act and the Dodd-Frank Act, has mandated a shift in power from management to boards, as evidenced by increased independence on the board (i.e., independence from management) and manifested in heightened requirements for audit committees, compensation committees, and executive sessions of the board.
- **Shift in power from boards to stockholders.** The increased influence of stockholders in corporate matters has

been demonstrated through developments such as shareholder approval of equity compensation plans, amendments to NYSE Rule 452 voting requirements (excluding broker non-votes from being counted in certain situations), majority voting in director elections, clawbacks of executive compensation, non-binding say-on-pay votes, erosion of anti-takeover measures, and withhold-vote campaigns.

Fundamental Principles in Corporate Law

Despite these corporate governance trends, several fundamental principles in state corporate law, particularly in Delaware, continue.

- **Corporate law remains director-centric, rather than stockholder-centric.** State corporate law, particularly in Delaware, requires that the business and affairs of a corporation be managed by or under the direction of a board of directors. Stockholders are entitled under state law to elect directors and vote on certain proposed corporate transactions, such as a sale of all or substantially all of the assets of the corporation, but they are not entitled to oversee the management of the corporation. That duty is entrusted to the board.
- **The business judgment rule is alive and well.** This bedrock principle in

corporate law—that a board's rational business judgment will not be second-guessed by the courts so long as directors have exercised their fiduciary duties of loyalty and care—has not diminished with other changes in corporate governance. Boards can take great comfort that the courts continue to uphold board decisions that are made rationally, in good faith, with due care, and with the best interests of stockholders in mind.

- **Boards should focus on the process of making decisions.** While it is still rare that directors are held personally liable for their conduct as directors, by some metrics the risk of litigation has increased in recent years. To protect themselves, boards should focus on the process of making decisions to ensure that they exercise the fiduciary duty of care. Directors should:
 - be active and engaged;
 - obtain access to relevant information;
 - obtain input from relevant board committees and board advisors;
 - actively deliberate decisions, asking relevant questions and discussing the information provided;
 - examine available alternatives; and
 - resist the pressure for a quick decision.

¹ Chancellor William Chandler is the former Chancellor of the Delaware Court of Chancery.

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Critical Issues for Boards of Directors . . .

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- **Ensure that the board's process and decision are documented adequately.** Board minutes should be drafted carefully and promptly and circulated to directors. The minutes should provide a clear record of what the board reviewed, the steps taken to make a decision, and what decisions the board made.
- **Director and advisor independence are important.** Director independence involves more than just an annual determination regarding stock-exchange independence requirements. Boards should take care to act independently and disinterestedly, particularly in the context of special committees established for litigation or a strategic transaction. In addition, boards should be aware of conflicts of interest that their advisors may have and take that lack of disinterestedness into account when weighing their advice.
- **Exercise special caution in conflict-of-interest or sale-of-control situations.** When a director stands on both sides of a transaction, the director must take care to disclose his or her interest in the transaction to the other

directors. In addition, the entire board should recognize that if the transaction is challenged, the presumption of the business judgment rule will likely not apply. The same is true of a so-called "Revlon transaction" where a corporation is being sold for cash. In these situations, rather than the deferential business judgment rule, the more exacting review standards of enhanced scrutiny or entire fairness will apply, leading the courts to examine the reasonableness of the board's process in a sale-of-control situation or to examine the transaction to ensure that both the price of the transaction and the process by which it was approved are entirely fair to the stockholders in the controlling stockholder setting.

- **Be aware of the discoverability of electronic communications.** Almost anything electronically distributed—in email or text messages, or posted on the Internet—can be retrieved and produced in discovery. While these forms of communication have become entirely commonplace, special caution should be taken when using them to discuss sensitive topics that may become the subject of litigation.

For more information regarding recent developments in corporate governance or any related matter, please contact your regular Wilson Sonsini Goodrich & Rosati attorney or a member of the firm's corporate and securities practice.



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