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# The Board's Reliance on Corporate Counsel

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*The in-house bar association.<sup>SM</sup>*



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## Mechanisms to Ensure Appropriate Board Focus

- Verify processes are in place to assist in identifying issues and information for board attention
- Engage board and management in discussion of expectations about how, when, and in what circumstances information will be provided:
  - what kinds of “red flag” events should trigger a report to the board?
  - what is the role of corporate counsel?
- Consider developing a written policy re when board should be informed of, or take action on, issues
- Consider what expertise/resources the board needs to determine what information it requires and to help process that information

## **Mechanisms to Ensure Appropriate Board Focus (Continued)**

- **New governance environment presents a paradox:**
  - directors' duties to be active and informed concerning material risks facing the company
  - yet, independence requirements mean that some directors in some companies have little direct knowledge about those risks
- **Corporate counsel have an obligation to ensure that directors are appropriately informed and focused on the important issues**

## **Compliance Is Necessary but Not Sufficient**

- Directors must monitor as well as direct management's performance
- Corporate crises often occur under the watch of honest directors whose downfall is simply not knowing or understanding
- Boards cannot fulfill their duties without relevant and timely information about strategy and risks

## **Role of General Counsel in Governance**

- Clarify any lingering ambiguity in the general counsel's role
- General Counsel is Advisor to Board and Management
  - Familiar with corporate governance best practices
  - Intimate knowledge of the company's activities and areas of risk
  - Responsibility for supporting board processes

## Role of General Counsel in Governance (Continued)

- General Counsel is Uniquely Positioned to Provide – and is responsible for providing – Board with Support

Source: New York City Bar, Report of the Task Force on the Lawyer's Role in Corporate Governance (Nov. 2006); See 62 Bus. Law 427 (2007); E. Norman Veasey & Christine T. Di Guglielmo, The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation, 62 Bus. Law 1 (2006).

## **Anatomy of the Role of the General Counsel**

- **The General Counsel has four general roles:**
  - Legal advisor
  - Corporate officer and member of the senior management team
  - Administrator of in-house legal department
  - Corporate agent in dealing with third parties (including outside counsel)

### **There can be at least ten functions subsumed within these categories:**

- Business and legal advisor
- Manager
- Mediator among corporate constituencies
- Compliance program designer or implementer
- Governmental affairs officer
- Manager or overseer of corporate records (e.g. minutes)
- Legal and business ethicist
- Corporate advocate
- Persuasive counselor
- Manager and educator on legal, enterprise, and reputational risk

## Anatomy of the Role of General Counsel (Continued)

- **Focus on only two of those ten functions:**
  - Compliance program designer or implementer and
  - Manager and educator on legal, enterprise and reputational risk

## Ethical Considerations Under State Law and Ethics Rules

**High integrity begins with adherence to the legal, regulatory and ethical framework:**

- State law fiduciary duties of due care and loyalty require that officers and directors must act in good faith in decision-making and oversight
- State ethics requirements must guide the General Counsel in many areas, including:
  - Competence and diligence (MR 1.1) and (MR 1.3)
  - Not enabling client fraud (MR 1.2)
  - Honoring confidentiality and its exceptions (MR 1.6)
  - Avoiding conflicts (MR 1.7)
  - Reporting wrong doing up the ladder (MR 1.13)

Source: References to “MR” are examples of certain Model Rules of Professional Conduct as adopted by the House of Delegates of the American Bar Association.

## **Ethical and Other Considerations Under Federal and Listing Rules (Continued)**

- Sarbanes-Oxley imposes responsibilities on management and the Audit Committee to establish and monitor internal controls and to develop compliance and whistle-blowing structures.
- The Act (Section 307) also establishes through SEC Rules (Part 205) some professional responsibilities on lawyers appearing and practicing before the SEC to report up the corporate ladder (and sometimes permits reporting outside the corporation to the SEC) evidence of material wrongdoing likely to hurt the corporation and investors.

## **Ethics and Other Considerations Under Federal and Listing Rules (Continued)**

- Federal Sentencing Guidelines encourage active involvement of the board in overseeing programs to identify potential risk of criminal violations and to promote a culture of ethics and compliance.
- New York Stock Exchange Rules require the Audit Committee to discuss policies with respect to risk assessment and risk management.

## The Persuasive Counselor and the Compliance Function

- As part of their duties to carry out with due care and in good faith their responsibility of oversight, directors must take steps to ensure (i) that there are reasonable systems and internal controls in place and (ii) that those systems are regularly monitored so that the compliance function is carried out appropriately. See Caremark and Stone.
- It should be noted that the overlays of Section 404 of Sarbanes-Oxley Act and the recent Emergency Economic Stabilization Act do not change the jurisprudence of Caremark and Stone.
- But, over time at least, they may change the expectations that underlie the directors' "known responsibilities."

## Questions that the Persuasive Counselor Should Ensure that the Directors Ask Themselves

- What are we aiming to accomplish, and how (corporate strategy)?
- What could derail our strategy?
- What assumptions underlie our strategy?
- Which of those assumptions could change/be wrong?
- What process did management use to identify risks?
- How is management dealing with the natural conflict between business unit and corporate views of risk?
- Have we achieved a common understanding of what triggers bringing an issue to the board's attention?
- What capabilities are required to address the risks? Where do we have capability gaps?
- Is there a common understanding about rights, roles, responsibilities and accountabilities on strategic risk?
- How can this discussion become a part of the regular routine?

## **Further Questions that the Persuasive Counselor Should Ensure that the Directors Ask Themselves**

- Is the board and are the appropriate committees focused on liquidity, availability of credit, valuation issues, hedging strategies and the like?
- Does the board have a clear understanding where these matters are delegated and the processes that management uses?
- Is the board and are the appropriate committees focused on financial, enterprise and reputational risk management?
- Has the board and have the appropriate committees revisited with management expectations about the company's risk appetite?
- Is the board and are the appropriate committees meeting regularly with the chief risk officer?
- Has the board ensured that the chief risk officer and General Counsel have adequate resources and appropriate reporting lines to bring any changes in material risks to the board's attention?

## Further Questions (Continued)

- Does the board and do the appropriate committees have access to the information that they need to provide oversight in these troubled financial times?
- Has the board and have the appropriate committees reviewed the incentive structure in the company and considered whether it is consistent with the agreed risk appetite?
- Has the board and have the appropriate committees reviewed executive compensation practices and considered how well they will withstand scrutiny in the current highly charged political environment?
- Does the board have the appropriate committee structure for its significant oversight obligations in the area of risk, finance, etc.?
- Has the board and have the appropriate committees reviewed board composition and director skill sets in relation to up-to-date competencies for oversight of the company's strategy, business lines and material risks?
- Has the board adopted a board leadership structure that ensures that the independent directors have a clearly defined leader?

## Recalibrating Board Thinking

General Counsel and outside counsel must see to it that boards recalibrate their thinking in decision-making and oversight to deal with what may have become a “crisis norm.” For example:

- Replace blind compliance with efficient compliance
- Get a second opinion
- Do a documentation audit
- Do a corporate governance audit
- Review existing D&O policies
- Plan for crisis
- Act while you still can
- Know what a good outcome will look like in advance—have a definable goal beyond simply ending the crisis
- Focus on the issues that can arise in companies facing possible insolvency
- Make sure the board has considered international complications
- If the company is public, think through the public company disclosure obligations carefully

## Conclusion

- The world of corporate directors is complex, challenging, and continually evolving
- Recent economic meltdown and its liability/regulatory consequences have intensified the directors' concerns
- By consistently “doing the right thing,” directors should be empowered, without reasonable fear of ultimate liability to advance the best interest of the corporation and the stockholders
- The role of the persuasive corporate counselor, particularly the General Counsel, is increasingly crucial in guiding directors

## **NACD Resources...**

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  - In-Boardroom Training Programs and Evaluations
  - Director Professionalism<sup>®</sup> Course
  - Publications
- **Peer Community**
  - Chapters
  - Governance Conference
  - NACD Directors Registry<sup>®</sup>
- **Leadership**
  - NACD Key Agreed Principles and White Papers

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