



CRISIS GOVERNANCE

The Science and Art of Navigating a Leadership
Crisis

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WHAT IS A CRISIS?

Any event that can have a material negative effect on the company and its stakeholders

Dermira shares drop 66% after surprise acne clinical trial failure

By Emma Court

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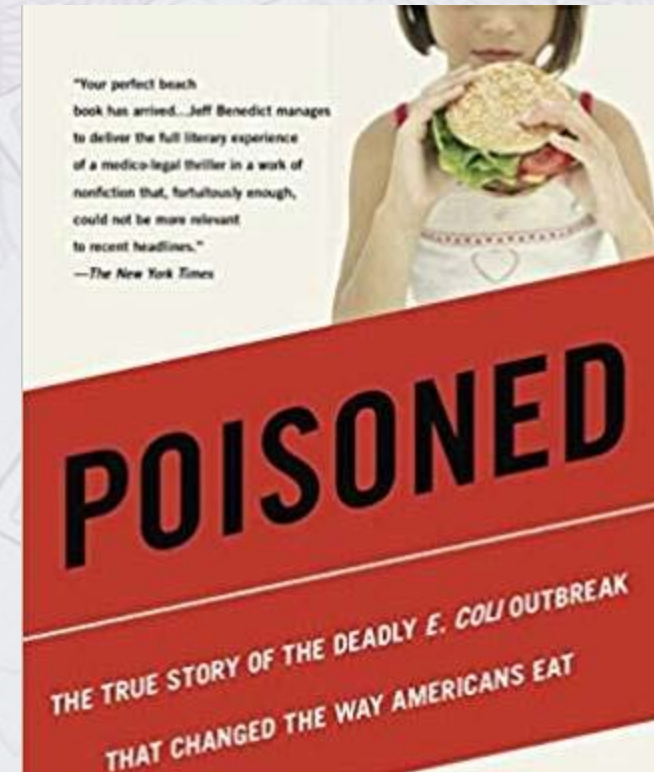


Aa

Wall Street had high hopes for the medication, which had a new approach to acne, aiming to cut down on oily skin



Getty Images



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WHAT IS A GOVERNANCE CRISIS?

A crisis that suddenly and unexpectedly disrupts the historical mechanisms of authority in an organization

Resign Now! Jack in the Box Franchisees Tell CEO He's Got to Go

Turmoil at the burger chain has been simmering since at least the summer.

Rich Duprey
(TMFCop)
Oct 21, 2018 at 2:08PM

Jack in the Box ([NASDAQ:JACK](#)) franchisees are all wound up, charging that the burger chain's CEO is no crackerjack and asking him to resign. They also want the board of directors to replace a number of other people on the management team who have contributed to the restaurant's lackluster performance and the destruction of the brand's value.

The dustup, which follows a no-confidence vote at the National Jack in the Box Franchisee Association (NFA) annual meeting this past July, has attracted the attention of activist investor Jana Partners, which established a 7.3% stake in Jack in the Box earlier this year. The hedge fund has sided with the franchisees, telling Bloomberg, "We share the franchisees' concerns about Jack in the Box's performance and the lack of urgency in addressing it."



Marvell Technology's Stock Plunges After Disclosing Accounting Probe

By Tomi Kilgore | Published September 11, 2015 | [MarketWatch Pulse](#)

Marvell Technology Group Ltd.'s stock tumbled 16% in premarket trade Friday, after the semiconductor company disclosed in a regulatory filing that it was conducting an internal investigation of certain accounting and internal control matters. "The investigation consists of a review of certain revenue recognition issues in the second quarter of fiscal 2016 and any associated issues with whether senior management's operating style during the period resulted in an open flow of information and communication to set an appropriate tone for an effective control environment," the company stated in the filing. Specifically, the company said it was focused on 7% to 8% of revenue recognized that would have

EXAMPLES OF CRISES

Governance Crises

- Financial fraud
- External investigation by governmental authority
- Internal investigation of CEO or other senior management for improper conduct
- Shareholder or director deadlock
- Sudden death or disability of CEO
- Termination of CEO

Other Crises That May Become Governance Crises

- Data breach
- Major public relations crisis
- Natural disaster/violence
- Safety incident

WHAT HAPPENS IN A GOVERNANCE CRISIS?

- Uncertainty who has authority to give instructions
- Contrary and contradictory instructions received
- Tribalism
- Employees lose faith and morale drops
- Large number of employees hit the job market
- Financial results suffer
- Lawyering up
- Decision-making slows to a crawl
- Investigation/remediation blamed for all the company's problems

RISK FACTORS FOR GOVERNANCE CRISIS

- Corporate “culture of fear”
- CEO perceived as untouchable/unaccountable to board
- Weak internal controls
- Tolerance of circumvention of internal controls
- Belief that the end justifies the means
- Weak persons in traditional oversight roles
- Corollary: departures of strong persons in oversight roles
- Siloed decision-making
- Overly-aggressive sales targets
- Unwillingness to disappoint the “street”
- Belief that survival of company depends on elevated stock price
- Excessive risk taking
- Money as organization’s sole goal and measure of accomplishment and recognition
- High turnover, particularly in finance, legal and HR

PREPARATION FOR A GOVERNANCE CRISIS

- Crisis response plans/protocols/procedures
- Alternative protocols/call lists for when senior leadership is compromised
- Effective code of ethics/training
 - Widely understood
 - Respected by senior leadership
- Effective whistleblower policy
 - Widely known
 - Trusted
 - Effective evaluation and escalation process
- Culture of accessibility and accountability of senior management
- Pre-identification of responsible body of the board
 - Often but not always the Audit Committee
- Strong leader of such body
- Succession planning

TYPICAL CRISIS CURVE



WHAT TO DO WHEN CRISIS OCCURS?

- ✓ Consult with experts immediately
- ✓ Suppress instinct to put worms back in can
- ✓ Preserve evidence
- ✓ Protect whistleblowers
- ✓ Assemble a team for planning and execution
 - ✓ Inside company
 - ✓ Outside company
- ✓ Identify process leader(s)
- ✓ Assure team participants of their job security
- ✓ Revise lines of authority
- ✓ Develop a plan including key interim milestones
- ✓ Develop communication strategy
- ✓ Make decisions collaboratively/eliminate silos

KEY TEAM MEMBERS

- Board committee of disinterested directors
- Or independent overseer if no disinterested directors
- Legal counsel, often multiple firms
- Independent auditor
- Forensic accountant
- Public relations/crisis management firm
- Investment bank

DECISION-MAKING CHALLENGES

- Routine business decisions require director oversight
- Directors not accustomed to making such decisions
- Matters under investigation overlap with ongoing operations
 - Conflict of investigators between investigating and making new decisions
 - Potential need for investigators to recuse from prior advice function
- Legal overlay of formerly routine business matters and encounters

WHAT TO ANTICIPATE FROM RECOGNITION TO RESOLUTION

- Internal investigation
- Expansions of internal investigation
- Challenging disclosure issues; strains on disclosure controls and procedures
- Auditors declining to issue audit or review opinions
- Defaults under debt and commercial contracts that depend on currency of financial statements
- Exchange delisting procedures
- Employee departures
- Increasing desperation of persons under investigation
- Lost friendships
- SEC/DOJ/Stock exchange investigations/enforcement actions/criminal prosecutions
- Shareholder and other third party lawsuits
- Difficult attorney-client privilege issues involving internal investigation
- Massive expenditures for outside advisors
- Activist shareholders

WHY DOES RESOLUTION TAKE SO LONG?

- Persons under question often highly valued in organization – desire to retain if at all possible
- Situations are complex
- Credible investigation takes a long time
 - Often millions of documents to collect and review
 - Often dozens of interviews
- Third parties will focus on the quality of the investigation
- A poorly conducted or rushed investigation likely to lead to even longer recovery as government, plaintiffs and activists fill vacuum

BETWEEN RESOLUTION AND DENOUEMENT

- Completion of delayed financial statements
- Restoration of good standing with stock exchange, creditors, customers
- Resolution of governmental investigations
- Resolution of plaintiff lawsuits
- Resolution of employee lawsuits
- Adjustment to new controls and oversight
- Replacement of older employees who do not fit in new culture

WHAT DOES DENOUEMENT LOOK LIKE?

- Investigation concludes with findings and recommendations
- Personnel changes, often substantial
- Recovery of financial vitality
- Culture of increased oversight/adherence to rules
- Departure of crisis professionals

APPROPRIATE POSTURE/STYLE FOR CRISIS GOVERNANCE

- Process-focused
- Available
- Practical
- Patient
- Self-confident
- Resilient
- Empathetic and respectful

QUESTIONS

