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Gibbons Del Deo's Alyce Halchak On The Impact Of Sarbanes-Oxley On Private Companies

The Editor interviews **Alyce C. Halchak,** *Gibbons, Del Deo, Dolan, Griffinger & Vecchione, P.C.*

Editor: Would you provide our readers with something of your background and experience?

Halchak: I have been with the firm since 1984. Prior to that time I was with the Internal Revenue Service and engaged in tax litigation. Here I have been involved in general corporate and mergers and acquisitions, for the most part, as well as corporate governance, compensation planning and leveraged leasing.

Editor: What made you gravitate in the direction of corporate law?

Halchak: My initial interest was in tax, but in time I realized that I had a much greater interest in the entire business, rather than one aspect of it. The more you know about a client's business, the better lawyer you are going to be for that client. In such circumstances you move forward with the client's business objective in mind, rather than with a legal agenda which may frustrate the client's business objective.

Editor: Can you tell us something about your corporate governance practice?

Halchak: I've represented a substantial number of privately held companies over the years, and I have seen a variety of issues arise relating to the fiduciary duty that directors owe to the shareholders. The importance of carrying out that duty, making informed decisions, working with the corporate officers to see that all necessary information is reviewed and considered and that those decisions are executed properly, and disclosing all appropriate information to the shareholders, is not unlike their importance to a public company. It is essential in both instances that the directors have a clear understanding of the issues under discussion, their responsibilities and the consequences that flow from their actions and decisions.

Editor: You've indicated that you have spent a considerable portion of your career in board rooms advising directors on a variety of corporate governance issues. How has Sarbanes-Oxley affected this aspect of your practice?

Alyce C. Halchak

Halchak: Many attorneys will say that the lessons of Sarbanes-Oxley are not new, and that the legislation only formalizes what we have talked about for years. In point of fact, however, Sarbanes-Oxley *has* gotten the attention of a great many people. The issues that it addresses have become public issues, matters of public debate, and that certainly is new. Even for a company to which it does not specifically apply, there is a recognition that this legislation amounts to a statement of best practices in the corporate governance area. In my practice, which, as I mentioned, has a focus on private companies, it has become much easier since the enactment of Sarbanes for clients to understand the importance of transparency and disclosure, moving information up and down the chain of authority, insuring that the governing board has the information it needs to make informed decisions, and of seeing to it that the outside auditors are providing information directly to the board rather than just to the CFO or the CEO. At the same time, my practice has become more complex. The demands of Sarbanes can be both burdensome and expensive. As a result, there are public companies which are considering going private in order to avoid the burdens and the expense.

Editor: Does the conclusion to be drawn from that mean that private companies are not safe to ignore the admonitions of Sarbanes-Oxley?

Halchak: Everyone, on both sides of the public company – private company divide, recognizes that Sarbanes-Oxley provides excellent guidance in this area. Companies which are not subject to Sarbanes are well advised to comply with the spirit of the legislation, when possible. If a private company seeks additional capital these days, any private investor or bank is going to rely on Sarbanes as a guide in its due diligence efforts. If the company is considering a public offering, whether it measures up against a Sarbanes-Oxley standard – even when formal compliance was not required in the past – becomes an important issue in the record before the investing public. Because one never knows when the formal standards of Sarbanes are going to become relevant, it is important to be prepared and, to the extent possible, to comply. Many of these companies are choosing to come under the umbrella of Sarbanes-Oxley even when, strictly speaking, they do not have to. In the present circumstances, that makes a lot of sense.

Editor: Do you think there is a difference between the fiduciary responsibilities of the directors of a publicly held company and those of the directors of a private concern?

Halchak: There is a difference. With a public company, there are shareholders who do not have access to information other than through management and the governing board. In such a setting the fiduciary obligations of the directors to a widespread group of shareholders is considerable. In the private company setting, the shareholders and corporate insiders may be one and the same, and the shareholders may be well

aware of all corporate matters. The shareholders are not relying on the directors to represent their interests and to provide them with company information. The shareholders often can represent themselves in these matters. I should point out, however, that in a private company, there is a duty owed by the majority shareholder to the minority. Perhaps not to accede to their wishes, but certainly to provide them with all appropriate information to enable them to exercise whatever rights they possess as minority shareholders. Similarly, the fiduciary obligations of the directors in a private company with third party investors, investors who are not corporate insiders, are also quite significant. Disclosure of information, transparency in the decision-making process, financial reporting, ensuring an appropriate degree of experience and expertise on the governing board and ensuring that the board itself is in receipt of sufficient information to enable it to make informed decisions, all of these things must be considered in determining the board's fiduciary responsibilities in such a setting. For this reason, I often recommend that the governing board undergo ongoing education, with an attorney or recognized expert, on the fiduciary duties of directors, on the competencies expected of the board, on the interested director issues, on Sarbanes-Oxley, and so on. And not just once, but continuously.

Editor: Of course, the guidelines for fiduciary responsibility vary from state to state.

Halchak: Yes, and so do the interpretations of those guidelines. Delaware provides a considerable body of statutory and case law on such things as the duty of loyalty, reliance on experts, the business judgment rule, and so on. Many states look to Delaware to provide a grounding for their statutes and interpretations in these areas. It is very helpful, then, for a governing board to have some guidance on the Delaware statutes and case law in addition to those of its state of incorporation. This is rather like a governing board being made aware of the Sarbanes-Oxley standards even where the company is not required to be in compliance with that statute.

Editor: Would you tell us about the role of Sarbanes in the M&A area?

Halchak: We already see its impact on financial statement due diligence. The due diligence checklist, even in the case of a merger of two private companies, is going to be influenced by Sarbanes-Oxley. For example, acquisition agreements often include representations inspired by Sarbanes regarding the company's financial condition and internal controls. Indeed, I believe that, whenever you have third party investment or financing or widespread shareholdings, it is important to comply with the Sarbanes standards to the extent it is possible to do so.

Editor: What is the role of the audit committee in the private company setting as opposed to that of the large public company?

Halchak: Many private companies do not have a formal audit committee. This is often a question of size, shareholders, financing sources and business volatility. As a general proposition I highly recommend that companies have a two-person committee or advisory committee – independent, if at all possible – to meet with management on a regular basis to review financial reporting, internal controls and any other areas significant to the business. It is important to have such a committee meet with the outside auditors so that the financial discussion imports an independent and objective perspective.

Editor: What about the role of outside counsel in the post-Sarbanes scheme of things? What are the kinds of things that should be handled in-house and what should be sent to outside counsel?

Halchak: Obviously, in-house counsel is necessary for the day-to-day, ongoing flow of the company's business. Outside counsel is very often important for major transactions and extraordinary events. It is very helpful for outside counsel to explain to the governing board – and particularly the audit committee – and senior management their duties and responsibilities under the circumstances, for example, if the company plans to enter the public arena or to embark upon a program of substantial acquisitions. The larger the company and the more numerous the shareholders or debt holders, the more likely it is that the standards of Sarbanes-Oxley should be considered, among a great many things, of course, and the more likely it is that outside counsel can make a valuable contribution.

Editor: What are your thoughts about Sarbanes in the long term? Is it something that will be forgotten in a few years, along with the corporate scandals that prompted its enactment, or does it represent the kind of fundamental change that the securities legislation of the 1930s represents?

Halchak: I think the latter. The concepts that underlie Sarbanes-Oxley are good ones, and I believe they are here to stay. The initial reaction of many was that the legislation was cumbersome, an over correction of the problem. The securities legislation of the 1930s inspired a similar reaction at first. Companies will learn to comply timely and efficiently. As a result, shareholders and other stakeholders will receive information necessary to make decisions on a timely basis – the right result whether a company is public or private. With the passage of time, further guidance from the SEC and experience with compliance, I think that the legislation will be streamlined and we will then be able to fully recognize and appreciate its true benefit.