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Corporate Governance: Best Practice Becomes Mainstream

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

Editor: Ms. Halchak, would you tell us how you came to specialize in corporate governance law?

Halchak: For most of my career, I have specialized in corporate and business law with a focus on mergers and acquisitions. The governance of business entities and, in particular, the fiduciary duties of directors and officers are, and always have been, a critical part of my practice. Because of the recent corporate scandals and the enactment of Sarbanes-Oxley legislation (“Sarbanes-Oxley”) and its stiff penalties for non-compliance, management and board members want to know and understand their obligations and what they must do to carry them out.

Editor: In recent years, this development appears to have accelerated. How has your practice been affected by the corporate scandals, Sarbanes-Oxley, and the regulatory structure that has resulted?

Halchak: I try to remind clients that the corporate scandals and Sarbanes-Oxley did not create the fiduciary duties that we hear so much about, but these events certainly did demonstrate the far reaching and disastrous results to companies, managements, boards, creditors and their advisors if these duties and a company’s governance structure are ignored. As a result, my governance practice has expanded to include ongoing education of boards, trustees and management; counseling boards in their evaluation of transactions, or conflict of interest situations, and representation of audit and special committees in internal



Alyce C. Halchak

investigations. In the past, this guidance was based principally upon state statutory law as interpreted by the courts. Today, we are guided by state corporate and business laws, Sarbanes-Oxley, federal securities laws and the listing standards of self-regulated organizations. I have seen my transactional practice also affected. Transactions generally involve a thorough due diligence process, but today this process includes new areas of inquiry: for example, review of whistleblower procedures and complaints and assessment of internal controls.

Editor: Speaking of advising the governing board, as opposed to advising the company, will you tell us about the role that board evaluations play in today’s climate?

Halchak: Given the intense, worldwide

competition facing companies today, and the consequent focus on corporate strategy, boards must add value. Quality boards recognize the importance of performance evaluations of the board and individual members in assessing their value. Boards must be an asset to the company, understand the business, know its competition, and be vital to the development of its long-term strategy. Evaluations can be extremely helpful in identifying the board’s strengths and weaknesses and isolating problems that may only surface through an interview process.

In today’s business environment, it is important that all board members understand that the board is committed to an ongoing evaluation process. This commitment should be set forth in the board’s and appropriate committee’s charters. A board that is committed to such a process is a board that effectively and efficiently oversees management, anticipates business challenges and successfully anticipates and overcomes corporate crisis.

Editor: I’m sure that you agree that the assessment that emerges from the evaluation process is only as good as the questions that implement it. Who formulates these questions?

Halchak: It is certainly appropriate to have independent advisors assist with the formulation of questions and the implementation of the evaluation process. Directors may not have the time or experience or may not be sufficiently objective. In these cases, a consultant may be essential. Whatever the method, it is very important that all board members participate in the process and contribute to the formulation of questions. I strongly recommend that management also be involved in assessing the board’s perfor-

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mance, determining the areas of evaluation and formulating the questions. The evaluation process should be developed and directed by the nominating and governance committee. It is this committee that identifies and vets candidates for board membership and reviews and evaluates current board members up for renomination. Developing and directing the formal evaluation process provides the committee with all the information that it needs to carry out its other responsibilities. A formal evaluation process also removes a great deal of subjectivity from this exercise. Boards and committee charters should set forth objective guidelines for evaluating the board and its members. The committee is charged with determining whether the board and the individual board members meet these board-approved requirements.

The initial evaluation is often the most comprehensive because it covers procedural as well as substantive questions. Subsequent evaluations generally can eliminate many of these procedural questions and focus on the pressing issues facing management and the board.

Editor: After the evaluation process is complete, what happens next?

Halchak: Questionnaires should be completed and returned to the nominating and governance committee. It is often wise to have several board members review the results so that there is consensus reached on the import of the responses. Interviews of some or all board members can be conducted. After the committee has completed its review and interviews, the committee chair reports to the board regarding the evaluation process, results, recommended action, parties responsible for the action plan and timeline. The board should receive a copy of the report sufficiently in advance of the meeting so that there is adequate time to review results, request additional information and consider the committee's recommendations. After the report has been given and the discussion concluded, the board should approve the action plan, parties responsible, and timeline. Subsequent board meetings should include progress reports on the action items.

At times, the evaluation results can be unanticipated. I recently directed a board evaluation which generated considerable questions about the company's strategy. Many board members sought greater participation in developing the company's long term strategy. Management had been unaware of these concerns. Management

took immediate steps to provide more detailed information regarding strategy at the quarterly board meetings; a strategy committee was formed comprised of board members and management, and, each board meeting included a report and full discussion of strategic planning. The board was now vested in this process, and management benefited from the board's broad experience and counseling.

Editor: You've alluded to one of the difficult things about the evaluation process — assessing individual performance. How do you do this in a way that is not divisive?

Halchak: That can be difficult. Again, it is generally wise to have evaluation guidelines approved by the board, well before the first evaluation is conducted and reflected in the board's and appropriate committee's charters. An evaluation based upon prior agreed upon standards will be more widely accepted by the board than one based upon criteria developed at the same time the evaluation is developed. Next, consider whether the results of individual evaluations should be reviewed by less than the full committee, for example, the committee chair and the board chair. Individual evaluations are often more effective and anonymity preserved if results are considered and discussed by a limited number of board members so long as the results are also discussed with, and recommended action approved by, the board.

Editor: In talking about sensitive information, how do you go about protecting it from plaintiffs' lawyers looking for opportunities?

Halchak: If boards are to be encouraged to conduct evaluations, identify problems and take action to remedy the problems identified, it is essential that the evaluations and remedial actions themselves do not create adverse consequences. This is an evolving and important area of the law. Where there are any concerns regarding potential adverse consequences, counsel should be consulted prior to developing and implementing an evaluation process.

Editor: Usually the only member of senior management who is also a member of the board is the CEO. Where do you draw the line between management and the board in meeting their respective responsibilities?

Halchak: There should be no hard and fast rules here. Clearly, management has a responsibility to keep the board fully informed — and the CEO and the CFO are key to this process. The board has the responsibility to *act* on matters that come before it based upon the information provided to it, management's reports, and any other information or counseling requested. The idea, however, that the board's responsibility is limited to strategy and "tree-top" oversight is clearly out of place in today's business environment. Lines are blurred and responsibilities overlap. Indeed, in a crisis situation, the board or one or more of its members are often called upon to assume interim operational responsibility. Complete and accurate disclosure of information by management and full discussion of issues and candor with the board are essential to a company's success and often, survival.

Editor: Many commentators have wondered whether form is trumping substance in terms of a governing board's responsibility. The board remains responsible for corporate strategy and continues to have a supervisory role over operations. In the current climate, however, the emphasis on deliberation and process appears to limit the time available for substance. Is this a fair comment?

Halchak: There is no doubt that many companies have spent a great deal of time and money responding to the requirements of Sarbanes-Oxley, SEC regulations and pronouncements and the SRO's listing standards. But why has this happened? Companies' disclosures to the public and other stakeholders were intentionally delayed, contained significant inaccuracies and were often misleading and failed to disclose properly, or disclose at all, many transactions or other significant events. The processes in place to ensure accuracy, completeness and transparency were fatally deficient.

Sarbanes-Oxley obligates officers and directors to be responsible and accountable, and imposes stiff penalties for failure to comply. Governing boards *should* have a clear understanding of their responsibilities, audit committees *should* consist of people with the requisite expertise and independence, and management *should* be responsible and accountable for the information it discloses about the company and its finances. Companies must establish a culture of integrity and transparency, and their governance principles must support and sustain this culture.