GC Growth: How the Law Department Contributes to Improved Board Performance

Corporate, Securities, and Governance


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CHEAT SHEET

- ***Board governance has changed.*** Regulations such as Sarbanes-Oxley and Dodd-Frank have mandated more independent boards, which can provide a keener and more effective look at how their company is run.
- ***Providing institutional memory.*** In-house legal departments represent a valuable source of continuity to the board, as CLOs often serve their companies for decades at a time.
- ***Becoming a trusted advisor.*** Experienced in-house counsel that come to intimately know the company and its business can earn a seat at the board's table as a leader and advisor.
- ***Granting directors access.*** From serving as a liaison with management, filtering legal reports and supplying premeeting "board packages," in-house counsel offer a variety of information services.

US publicly-held companies have faced significant reputational challenges in the current century. The scandals of the Enron era (2001–2002) and the financial failures of 2008 raised doubts not only about the integrity of the nation's financial markets, but also about corporate leadership and governance.

Despite these cataclysmic events, the fundamental corporate law duties of public company directors have changed relatively little over the past 15 years. Directors continue to be subject to the duty of loyalty and the duty of care, with the basic contours of these duties remaining relatively stable in leading jurisdictions. On the other hand, new laws and regulations enacted by the US Congress and the Securities and Exchange Commission (SEC), as well as listing standards adopted by the stock exchanges, have significantly changed the responsibilities of public company directors. Through the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act in 2010, regulators sought to improve the performance of public company boards and restore confidence in US financial markets.

Beyond changes required by these new regulations, in an effort to improve their own performance and add value to the enterprise, public company boards have significantly changed the way they operate. In addition, new approaches to communication and collaboration between all the stakeholders involved in corporate governance (directors, officers, shareholders and regulators), as well as new challenges from activist shareholders and proxy advisors, have significantly impacted the roles played by public company directors.

In many public companies, the way the law department supports the work of the board has also evolved significantly over the past 15 years. Rather than looking to the lawyers only for advice on more traditional "legal" matters — such as fiduciary duties, strategies in pending litigation and deal points in proposed acquisitions — public company boards have come to expect the general counsel and legal team to collaborate with the board, to help the board improve its performance and build value for the enterprise. We believe that much of this evolution has occurred in response to specific client needs. As a result, there are many differences from company to company in the way in which in-house legal teams view themselves and are viewed by their clients. It is clear, however, that to a greater extent than ever before lawyers are expected to exhibit leadership behaviors similar to their business colleagues. In our view, successful leadership on the part of lawyers is a function of their willingness to seek and act on opportunities to take initiative and to become true business partners. More than many other areas of practice, a company's governance needs can provide rich opportunities for lawyers to use their unique skillsets and insights to take initiative and create value for the company.

To take full advantage of these opportunities, in-house lawyers need to understand not just the "what" but the "why" behind the changing governance landscape. If they can demonstrate a meaningful grounding in the relevant background, their leadership initiatives will be welcome. However, for reasons that are discussed below, the director community has become much more well-versed in governance matters and have honed abilities to assess whether or not a potential advisor is worthy of their trust. This article will provide a better understanding of how the governance landscape is evolving, and suggest how this has created changes in the way that boards and individual directors have come to act and the resultant changes in their needs for support, and to better inform leadership initiatives taken by in-house legal teams.

Eleven major changes in board governance since 2000

Our experience suggests that the manner in which public company boards conduct their own operations and govern the enterprise has changed in the following ways since 2000:

1. **Boards are more independent.** A fundamental theme that grew out of the Enron era was the requirement for public company boards to be comprised of more independent directors, with boards addressing key responsibilities through committees comprised of independent directors. Not only has there been an increase in the number of independent directors, but the increased use of executive sessions and the emergence of new models of leadership for the independent directors have increased the effectiveness of the independent directors. While Sarbanes-Oxley focused on the independence of the company's directors and the responsibilities of the directors in overseeing the work of the independent auditors, Dodd-Frank also added requirements that the compensation committee be empowered to retain independent advisors.
2. **Boards focus on director skills and experience.** While regulators and commentators attributed many of the Enron era corporate failures to the lack of independence of corporate boards, boards faced a different accusation with respect to the responsibility for the Great Recession. Critics suggested that corporate boards had been "asleep at the switch" or were incompetent to oversee management, particularly in the critical area of risk management. In response, the SEC imposed regulations requiring the company to describe the specific skills and experiences that each director brings to the board, and corporate boards now live in the era of the "skills matrix." Many public company boards now maintain a grid showing the disciplines that are most important for the board to possess, with the board assessing which of its directors are experienced in each of these subject areas. Boards now focus on board succession, considering what skills will be most important to the future success of the company and which directors will bring those skills to the board. The board must recruit new directors where this matrix shows that there are or will be gaps.
3. **Directors are working harder.** Years ago, a director who served on six or eight public company boards might have been viewed as a captain of industry, with service on multiple boards being a badge of honor. Beyond attending board meetings and some minimal time for preparation, relatively little time was required of corporate directors. Now, with concerns about directors who may be "overboarded," directors are serving on fewer boards and devoting more time to each of their boards. In addition to attending board meetings, directors report that they are far more engaged in company business between meetings and also spend more time preparing for and following up after meetings. Directors collaborate with senior management on an ongoing basis and stand ready to dedicate significant time to the

company in times of crisis or transition.

4. **Decision making is an ongoing process.** Previously, the work of a public company board was more episodic, with the activity of directors being limited primarily to quarterly meetings and annual briefings on key topics (such as strategy and risk management). Now, management provides directors with regular updates on key issues, as well as a regular flow of reports and information. For example, rather than strategy and risk management being considered on an annual basis, with the board receiving reports from management, these subjects are touchstones for all important corporate decisions, with directors collaborating with senior management on these topics.
5. **Boards are operating more efficiently.** Public company boards are able to take on additional responsibilities because they are operating more efficiently. One of the primary factors contributing to the greater efficiency of public company boards is their increased use of board committees. In addition to the three traditional board committees — audit, compensation and governance and nominating — many boards have created committees to oversee matters such as finance, compliance and regulatory affairs, and corporate responsibility and sustainability. Directors suggest that board and committee meetings have also become more efficient, with the circulation of better materials in advance of meetings, the use of detailed agendas for meetings, and better use of outside experts to advise the board, for example on compensation matters and board development.
6. **Boards are focusing on their own development.** Directors of public companies are focusing proactively on processes that will improve the performance of the board, as a governing body. They take a more holistic approach to board development, with processes that were once thought of as distinct now feeding into each other so that both the board and individual directors make greater contributions to the company. Board selfassessments determine the skills and experiences that are needed; and new candidates are recruited to fill these roles; new directors participate in thorough onboarding; all directors have ongoing training and development; the board critically evaluates its own performance and plans for its own succession; underperforming or difficult directors may be asked to leave. This cycle repeats itself and is also modified to reflect the strategy and position of the company.
7. **Boards are more effective in overseeing management.** Whereas the work of a public company board was once more passive, over the last decade boards have become far more engaged in and proficient at overseeing the company's management. Rather than merely receiving reports from management and voting to approve or disapprove management's proposals, boards are interacting and collaborating with management to improve corporate performance. Boards and members of senior management share understandings of the types of matters that the board wishes to delegate to management, as well as the types of matters where the board wishes to be fully engaged. More meaningful collaborations with senior management have produced an added benefit in the area of management succession planning. Directors work with additional members of the management team, getting a more informed view of the company's bench strength.
8. **Boards have more effective leadership.** Over the past decade, many boards have come to recognize that public companies perform better with two leaders — a chief executive officer to manage the company's business and an independent board leader to manage the board of directors. Many companies have split the roles of CEO and board chair, and provided the board chair with a healthy portfolio of responsibilities. Even where the CEO continues to serve as board chair, many companies now have an independent lead director or presiding director with important responsibilities. These responsibilities may include communicating with the CEO about expectations and performance, keeping board discussions at the right level, dealing with difficult or underperforming directors, and communicating with key stakeholders of the company.

9. **Boards have a more sophisticated view of shareholders.** As directors have increasingly recognized that they are representing the interests of shareholders, they have also realized that there are many types of shareholders that use their ownership of the company to pursue different objectives. An activist shareholder seeking to effect an immediate change in corporate strategy will behave very differently than the index fund expecting to hold shares over a long time horizon, and directors may play different roles in communicating with these different types of shareholders. In addition to understanding different groups of shareholders, directors will do well to understand the proxy advisory firms, such as Institutional Shareholder Services, Inc. (ISS) and Glass, Lewis & Co. By providing recommendations to large shareholders on the voting of proxies, these firms have come to exert substantial influence on corporate governance over the past 15 years.
10. **Director elections are no longer taken for granted.** While public company boards continue to be self-perpetuating, with shareholders having a relatively passive role in the nomination and election process, several factors are now providing shareholders with more powerful inputs into the election of directors. Most public companies provide their shareholders with an annual "say on pay;" majority voting has become widespread; many types of corporate events can trigger withhold campaigns against directors; and proxy access is becoming a new reality for many large public companies. As shareholders play a more meaningful role in the nomination and election of directors, directors and boards have become more attuned to the issues that will influence their voting.
11. **Boards are using disclosure to get credit for their good work.** Fifteen years ago, we might have said that the most a company can achieve through its proxy statement is compliance with some highly technical SEC rules. These rules mandate detailed disclosure about executive compensation and discussion of some isolated aspects of corporate governance. While SEC rules have changed relatively little over this period, companies have come to view the proxy statement as an important channel through which a board presents its views on corporate governance. Rather than page after page of line items responding to SEC rules, the board now uses the proxy statement as a holistic document where it can "get credit" for improving the company's corporate governance.

Should the general counsel serve as corporate secretary?

We frequently hear the question, "Should the general counsel serve as corporate secretary?" and we always give the same answer: "It depends." Indeed, whether the general counsel (or another member of the law department) should serve as corporate secretary will vary from company to company and with the role of the corporate secretary at that particular company.

The key responsibilities of a corporate secretary may include:

- Managing board and committee meeting logistics, and attending and recording minutes of all board and committee meetings;
- Facilitating the preparation of board and committee materials and board communications;
- Overseeing corporate disclosure and compliance with stock exchange listing standards and various SEC reporting and compliance obligations;
- Monitoring corporate governance developments and helping the board understand changing governance practices and investor expectations;
- Serving as a source for investor communication and engagement on corporate governance issues;
- Preparing the annual proxy statement and coordinating the annual shareholder meeting; and

- Coordinating new director orientation and assisting in director training and development.

A smaller company with a relatively simple business and a small law department will typically have the general counsel and corporate secretary roles combined. The general counsel may seek help from non-lawyers within the company to manage some of the day-today aspects of the corporate secretary function.

A larger company with more complex business operations may find that separating the roles will allow the general counsel to focus on the business of the company and the corporate secretary to focus on the governance of the company, ensuring that the details related to the “care and feeding” of the board are thoughtfully addressed. Still, the corporate secretary may be an attorney in the law department, who is experienced in board matters, or someone outside the law department.

Following is a summary of some of the reasons that a company might choose to separate the roles or to combine them:

- Arguments for separating the roles:
  - (a) While there is overlap, the two jobs really have different responsibilities.
  - (b) For large, complex companies, the GC may not have time to handle or even supervise the secretary functions.
  - (c) The corporate secretary role involves mostly matters that are not primarily legal in nature.
- Arguments for the GC to serve as the corporate secretary:
  - (a) If you separate the roles and the corporate secretary is a lawyer, the board may be confused as to who is the board’s lawyer. Also, since the GC will ultimately be held accountable for adherence to disclosure and corporate governance rules, there can be significant confusion as to who should have primary responsibility for oversight of disclosure processes and developing and maintaining the company’s approach to corporate governance.
  - (b) There is considerable overlap in the roles.
  - (c) The most significant corporate secretary functions involve legal requirements, in one way or another.

How law departments can contribute to the work of the board in this new era

As we consider the changes in board governance over the last 15 years, it becomes clear that public company directors are seeking increased support and collaboration from all those who support the work of the board — whether the law department, the corporate secretary, governance professionals or financial or risk management officers. Our experience suggests that most public company law departments can contribute to the work of the board through the following approaches:

Provide institutional memory and continuity for the board

Institutional memory. The tenure of the general counsel and senior members of the law department often exceeds the tenure of the CEO and other senior officers of the company. Boards also face challenges that even the most engaged director may find difficult to track. As such, it is natural that the board may come to view the law department as the institutional memory of the company, not only with respect to legal matters and corporate governance, but also other board and corporate matters.

Vetting prospective directors. The law department will play an important role when the board is considering adding a new director. Among the matters that a board may wish to consider in evaluating a prospective director are whether there are items in the director's background that may cause a negative reaction by investors and analysts and whether the prospective director will be free of conflicts of interest and related party transactions. In additional, the law department will consider whether the prospective director would be considered independent, whether there may be related person transactions that would have to be disclosed, and whether the prospective director will meet the enhanced independence requirements for service on the board's audit or compensation committees.

Role in recruiting/on-boarding. Our experience shows that the law department will also play an important role in recruiting new directors for the company and helping new directors become productive members of the board. The prospective director will have practical questions about how the board operates, as well as questions about how the company protects its directors. The law department will play an important role in providing comfort to the prospective director about indemnification of directors, laws that may affect the director's liability and the type of insurance that the company maintains for its directors. After the new director has joined the board, the general counsel often plays in important role in helping him learn about the board, so that he will be able to quickly contribute to its work.

Help the board plan its calendar and agendas

The annual calendar. While the task may appear to be mundane, one of the critical responsibilities of the law department is to ensure that, over the course of the year, the board fulfills those responsibilities placed on it by laws, regulations and stock exchange listing requirements, as well as its own governing documents (for example, the charters of the board's committees, the company's corporate governance guidelines and the company's other policies). Careful planning ensures not only that the board completes all required tasks, but that the board addresses its responsibilities in an efficient manner.

The meeting calendar. While the annual board calendar ensures that the board carries out its responsibilities over the course of a year, the law department plays a different role in planning the actual meetings of the board. Depending on how many committees the board has and how it uses executive sessions, a typical board meeting may actually consist of four to eight separate meetings over the course of two days, so planning the agendas for these meetings is a critical responsibility for the law department. Directors may also benefit greatly from informal time together, as well as with members of senior management.

From meeting to meeting. The caricature shows directors hustling to the airport the minute the board meeting is over and, in the old days, the director may not have given much thought to the company's affairs until a few days before the next meeting, typically three months away). In the new era of board governance, directors will continue to focus on the work of the board between its meetings and the law department facilitates this work by monitoring items that require follow up and ensuring the flow of information to directors between meetings.

Between Board Meetings

Traditionally, most of the action for directors of public companies occurred at quarterly board meetings. Increasingly, directors are engaged in company business between meetings, and the general counsel can play an important role in facilitating director engagement in the period between board meetings:

- *The matchmaker* — Assigning specific members of the law department to support the work of each board committee has proven an effective approach to supporting the work of the board's committees. The general counsel may serve as "matchmaker," monitoring the collaboration between the assigned attorneys and the committee chairs, to ensure that they have the right working relationship.
- *The gatekeeper* — Directors seek direct access to members of senior management, as well as employees deeper in the company. The general counsel may play an important role in arranging for directors to meet with company personnel, and keeping appropriate company personnel in the loop, both before and after the director conversations.
- *The curator* — General counsel often present their boards with periodic updates on corporate governance, but directors also like to receive interesting reports, surveys and articles on an ongoing basis.
- *The monitor* — The general counsel will often maintain the "to do" lists that arise out of board and committee meetings and work with board leaders to prepare for their next meetings. He will be responsible for tracking items from one meeting to the next, and seeking director engagement to make progress on open issues.
- *The confidant* — Over time, the general counsel of a public company should seek to develop a relationship with each company director. Chatting with every director on a regular basis, even if only to "check in," allows the general counsel to develop a rapport, and will facilitate more important conversations that may need to occur.

Provide directors with information and access

Provide directors with information and access. Many board members report that, between meetings of the board, they communicate with the general counsel more frequently than with other senior officers of the company. Increasingly, directors seek to learn about the company's business not only through meetings and conversations with senior management, but through broader contacts in various areas of the company. While companies may offer their directors open access to managers and employees, many boards prefer an approach where a member of the legal department or the corporate secretary will serve as a liaison with the person who the director will meet. Directors want to communicate directly with members of management on a variety of subjects, but these conversations may require careful planning and follow-up.

Present the right kind of reports. As public company directors place greater emphasis on having more efficient meetings, and the range and complexity of legal and regulatory matters that affect companies have expanded, the general counsel faces the challenge of presenting the right information to the board. While directors want to be confident that the company is adhering to even relatively insignificant laws and regulations, and have processes for managing even relatively unimportant cases and controversies, they do not want company attorneys to spend too much of the board meeting reporting on routine matters. Directors want to hear about legal issues and cases that are important to their decision-making, or that are otherwise important to the company, without becoming mired in a review of the litigation docket. Rather than reviewing the docket or developments in specific cases, directors want to understand the company's philosophy and processes in managing litigation. Similarly, directors want to understand the how the company's compliance programs operate, rather than becoming mired in the details of specific matters.

Provide directors with the right tools. In 2015, it is understood that the board will have a portal for directors to receive what was once the pre-meeting "board package". The law department will often play an important role in setting up this portal and operating it on an ongoing basis, but the law department should also consider features that may enhance the portal. In addition to providing a repository of corporate documents, the portal may offer directors a library of thought leadership on corporate governance, lists of upcoming development opportunities and other resources. The law department will also need to weigh in on certain aspects of the portals content and features, with appropriate consideration of record retention and privilege issues.

Provide leadership to the company's corporate governance effort

Manage the company's governance profile. While some public companies are content to follow prevailing practices in their approach to corporate governance, other companies seek to improve their position with their stakeholders build the corporate brand by being viewed as leaders in corporate governance. The law department will often take the lead in developing broad principles that will guide the company's approach to governance, with these broad principles providing a framework for making individual decisions.

Partner with board leaders and the governance committee. Applicable regulations and stock exchange rules impose numerous responsibilities on the board's audit committee and compensation committee, but the governance committee is largely left to set its own agenda and it is well-positioned to take initiatives. Our experience shows that effective partnering between the law department and the governance committee can significantly improve the company's governance. By being well-situated among thought leaders in corporate governance and sharing information with the governance committee, the law department serves as a valuable resource on prevailing practices, spots emerging trends in governance and develops approaches that will be appropriate for the company.

Be the board's trusted advisor

Maintain Independence. Independence is often cited as a critical trait of the general counsel, but the general counsel of a public company must ask the question, "Independent of whom?". The company is the client of the general counsel, so she must consider the interests of shareholders in every decision, and she reports to the board, all of which suggests that it is independence from the personal interests of other members of senior management that may be critical. The general counsel advises members of senior management on a day-to day basis, but being able to advise the board independently of senior management is vital in situations where other members of senior management may be pursuing their own interests.

Wisdom and perspective. While less experienced lawyers tend to limit themselves to legal advice, board leaders confirm that the best general counsel stand out for coupling their knowledge of legal matters with strong business acumen. Given long tenure with the company, exposure to and engagement in all aspects of the company's business, and commitment to independence and the best interests of the company itself, the general counsel is positioned to move from advising the board on isolated legal matters to being a trusted advisor to the board. Rather than serving only as an advisor on particular issues, the general counsel earns a seat at the corporate board table by bringing his or her knowledge of the company's situation and strategy to the board room and being fully engaging with senior management and the board in making the company's most important decisions.

Distinguishing between legal advice and business advice. As the successful general counsel moves from the more limited role of providing legal advice to collaborating with the board and senior management in making the company's most important decisions, he or she must be cautious to ensure that the board will understand the type of advice being provided. The board is more likely to defer to the general counsel on legal matters than on business matters, and the general counsel should not "play the legal card" when providing views on business matters. The board may treat the general counsel as a peer in making business decisions, but directors still want to understand when the general counsel is addressing a legal matter and when he or she is participating as a business advisor. Note that this becomes more complicated when the general counsel is responsible for a business function — for example, human resources or business development.

Build a culture in the law department to support the tone set by the board

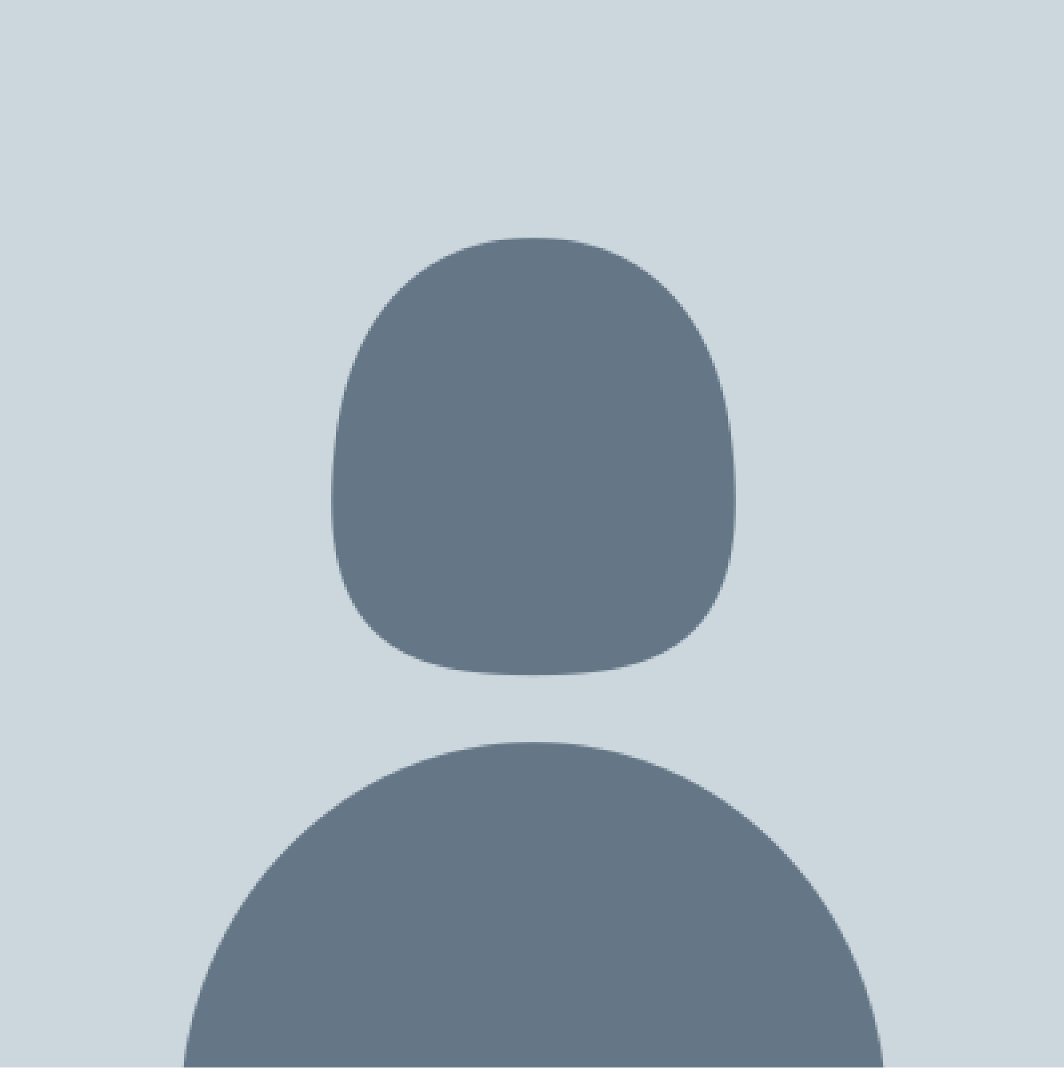
The literature and commentators emphasize the importance of "tone at the top" and developments over the last 15 years confirm that the board plays a critical role in establishing the tone for the entire organization and that this tone is an important corporate asset. In recent years, companies have also emphasized the tone at the middle and bottom, as they seek to ensure that the approaches and priorities set by the board take hold throughout the organization.

Each law department will have its own culture and strategies. As public company boards focus on the tone at the top, the general counsel should ensure that the culture of the law department is consistent with and supports the tone that the board sets for the entire organization. The general counsel will ensure that attributes such as conservatism, transparency and independence are part of the law department culture but may also seek to emphasize teamwork and collaboration. These attributes will help the organization create value and also come into play in making decisions on specific legal matters and in supporting the work of the board.

Conclusion

Since Enron and continuing through the financial crisis, public company boards have worked hard to restore confidence in the integrity of US public companies. They have gone far beyond requirements imposed by new laws and regulations in efforts to improve their own performance. Law departments have played a crucial role in this process, not only advising boards on governance, but going well beyond the role of providing legal advice to collaborate as trusted advisors to the board and take an important role as leaders of the company. Looking forward, law department leadership and initiatives will be even more important to successful corporate governance as directors undertake increasingly ambitious approaches to carry out their duties and contribute to their companies.

[Bruce N. Hawthorne](#)

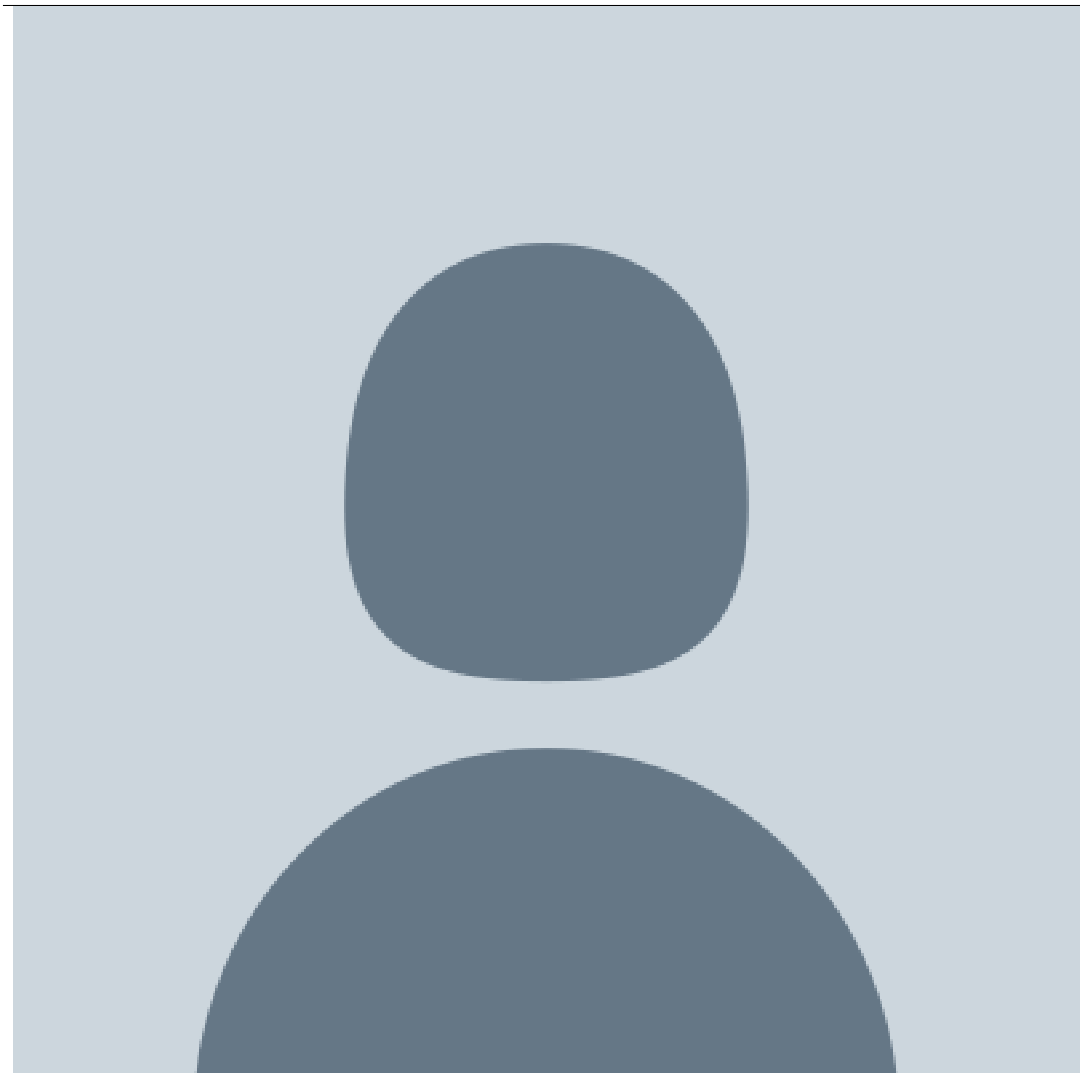


Chief Legal Officer

Huntington Ingalls Industries, Inc.

Bruce N. Hawthorne served as the first general counsel of Huntington Ingalls Industries, Inc., when it was spun-off from Northrop Grumman in March 2011, and currently serves as its chief legal officer.

[Jeffrey M. Stein](#)



Partner

King & Spalding LLP

He and has served as primary corporate governance counsel to Huntington Ingalls since it became an independent public company.