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BOARD MATERIALS

The Latest Frontier: Using iPads for Electronic Delivery of Board Materials

By Kris Veaco

This is an interview with Kris Veaco, President and Founder of the Veaco Group (*VeacoGroup.com*) conducted by the Editor of the *Corporate Governance Advisor*, Broc Romanek. Kris is a corporate securities lawyer and corporate governance specialist, who was in-house for many years running the corporate secretary function for several large public companies before starting her own corporate governance consulting firm.

Romanek: Kris, you've been doing some research into using iPads as a way for Boards of Directors to receive and view board materials in response to requests from some clients who are looking to go that route. What have you found?

Veaco: Yes, one of my clients recently rolled out iPads with their board to be used for their board materials and meetings and they asked me after the fact about establishing some organization for the materials. Their IT staff had led the project up to that point. The General Counsel wanted to create folders on the iPad to house various reference materials for the board.

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Kris Veaco is President and Founder of the Veaco Group (VeacoGroup.com)

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When I was in-house, I was responsible for overseeing the electronic delivery of materials to our board using a Web portal, so I know what was involved with that project and was excited to learn about how directors could use iPads to view their materials and how that would be different from my earlier experience.

So far, I have come away thinking that the iPad itself is not really set up to be used to house large quantities of highly sensitive materials such as board materials, or even a set of folders. In this case, the client creates a PDF document for each board meeting consisting of the agenda and all of the materials, e-mails the PDF to the directors and they upload that one long document to an iBook where it is stored on a Bookshelf on the iPad until it is removed. This is not my favorite way.

I have to say that I also have concerns about the materials sitting on the iPad after the board meeting. Directors will consciously have to remove the document, which they may not always do. I think there are better solutions.

Romanek: Do you have a sense how many boards are using iPads for their board reading?

Veaco: More than you would think. I recently conducted a brief survey of my colleagues at the Society of Corporate Secretaries and Governance Professionals. About 10 respondents had - or were in the process of - making iPads available to their boards for viewing board materials. A couple were waiting for the iPad2 that just came out for improved functionality.

In some cases, the companies had already been using a Board Portal for secure electronic delivery of board materials and so were just adding the iPad for viewing. In other companies, they were actually using the iPad to roll out electronic delivery of board materials for the first time.

In all cases, the people I spoke to were counting on the iPad to increase acceptance of electronic delivery of the materials. Most are using one of the existing Web portal providers rather than trying to create something themselves, which I recommend. The reason I like this solution is that these providers have thought out the organization of the board materials, have security features around who can see what and at least a couple of the more well-known providers have very strong security around their systems. I used one with my board when I was in-house - and security was key.

Romanek: How do board portals relate to iPads?

Veaco: The iPad just adds a little more excitement about using a board portal, and at least for my clients, it really has increased acceptance of electronic delivery – even though their particular solution is not elegant.

A few of the Board Portal providers have recently added iPad apps to facilitate viewing and downloading materials. One feature that I particularly like is the ability to download the most recent set of materials directly to the iPad into a secure spot just prior to the board meetings, and so an Internet connection during the meeting is not required. Look for this capability when you screen providers. You don't want any issues with a connection not being available. I've seen that problem with another client where spotty wireless connection made meetings difficult since their board materials were solely online.

There should also be a feature whereby the local version of the materials is automatically removed from the iPad after a short period of time. The online secure portal will continue to have the meeting materials as well as any other board materials available so the directors have continued access, but they just are no longer stored locally on the iPad.

Romanek: Are companies allowing boards to use the iPad for personal use as well as for board meetings?

Veaco: Most people I spoke with said they expected the board to be mindful of the company's policy with respect to personal use of

company equipment, but they also wanted the directors to play around with the iPad so that they were comfortable with how it worked. These companies were not really concerned about directors downloading useful apps. One of the companies I spoke with provides online news content and they wanted their directors to use the iPad to see their products. An IT security person I spoke with suggested that if directors have concerns about downloading a particular app, they could check with the company first.

Shortly after an assignment from a client, I moderated a panel at the Society of Corporate Secretaries' Essentials program in Florida, and one of my panelists, Gina Merritt Epps, Corporate Counsel and Secretary at South Jersey Industries, spoke about successfully implementing a board portal, including these important tips that are obviously based on experience (one of the points I really like is once the decision has been made to go this route, get some key directors involved in the process – and include at least one of the most resistant):

- When deciding on a Web portal, consider its "look and feel" and its ease of use so that the transition from a hard copy document is easier.
- Select a Web portal that prints the materials with ease.
- Use the Web portal to store other information such as contact information, materials used for director orientation, meeting minutes, committee charters. When I was in-house we used to upload individual director compensation statements and legislative white papers, law firm memos – all of which the directors found useful and it drew them to the site more often. They could view these materials at their convenience.

Just to wrap up: there is definitely a trend happening here, and I think directors are more apt to accept electronic delivery of the materials if it involves an iPad rather than just through their regular desktop or laptop computers. There is the "coolness" factor that wasn't present before. There are also some great cases to protect the iPads, one of which also has a regular keyboard that some prefer. And I also recommend using an existing board portal provider rather than trying to create something themselves. People should look closely at those providers that have developed iPad apps. And of course, the security offered by the provider for your confidential board materials continues to be at the top of the list of considerations.

A team approach to electronic delivery of materials to your board is essential and IT really needs to be involved. I also think it is very important for the corporate secretary to be involved in that decision, as they are in the best position to know what will work best with a particular group of directors - and for their own organization as the administrators.

Keeping Up with CEO Turnover: A Study

By Annalisa Barrett

The departure of the CEO, whether planned or unplanned, is always a significant event for the corporation. Many chief executive transitions go smoothly, leaving the company's performance unaffected. At other firms, however, CEO departures can cause a significant amount of distraction for the management team, stealing attention from strategic issues that increase firm value. The Wall Street Journal dubbed 2010 the year of "dramatic departures"[1] with executives like Mark Hurd at Hewlett Packard, Tony Hayward at BP PLC, and Don Blankenship at Massey Energy leaving the top spot after enduring controversy.

A recent study conducted by Equilar, the leading provider of executive compensation data and research, identified 381 S&P 1500 companies that had a change in CEO during the timeframe between 2007 and 2009. Of the three years studied, 2008 had the highest level of CEO turnover, with 156 CEOs leaving their companies. Falling slightly behind 2008, the number of executives leaving the CEO position during 2007 and 2009 was equal to 126 and 138, respectively. The following chart shows the number of CEO resignations during each calendar year.

Of the 381 companies studied, 348 changed their CEO once during the study period, while 33 changed CEOs more than once. 420 departing CEOs and 374 incoming CEOs are included in the study.

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CEO Age

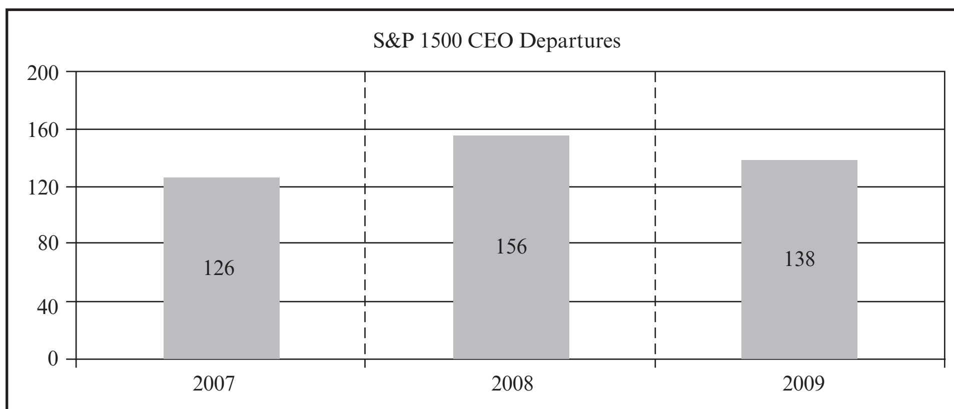
Although the age of a CEO does not necessarily dictate the timing of his or her departure, chief executives often step down as their age advances. These departures can be for personal reasons, or to comply with mandatory or suggested retirement ages imposed by the company's board of directors. Unsurprisingly, the incoming CEOs included in this study are, on average, younger than the executives they are replacing. As shown in the graphs below, departing CEOs are more likely to be in their 60s, while incoming CEOs are most often in their 40s or 50s.

The youngest person to step down from the CEO role during the timeframe studied was 37 years old; the oldest was 88 years old. The median age of departing CEOs was 60. Among the incoming CEOs, the youngest person to take the reins was 29 years old, while the oldest was 70 years old. The median age of incoming CEOs was 51.

Internal vs. External Replacements

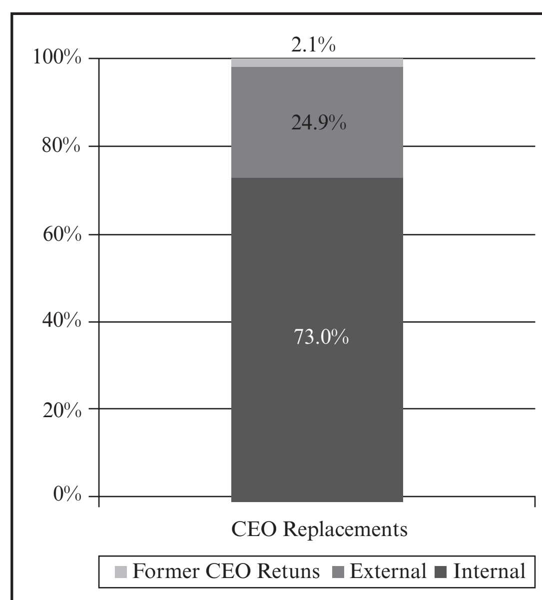
It goes without saying that the person selected to replace the departing CEO plays a major role in the success or failure of the leadership transition. A key consideration is whether the replacement comes from inside or outside the company. There are pros and cons with each approach:

- An inside candidate offers the benefit of institutional knowledge and an understanding of the company's culture. However, many internally promoted CEOs can carry over negative habits or outdated thinking from a predecessor. Additionally, if there is more than one qualified internal candidate, the selection process can cause those top executives passed over for the CEO position to leave the company for other opportunities.



- An external candidate, on the other hand, can bring new ideas and varied experiences to the company. They may also have the ability to make sweeping changes, unfettered by a company's traditions or existing processes. On the downside, externally promoted candidates can have a hard time assimilating to the culture of the organization and gaining the trust and support of the existing management team.

In a study of global CEO turnover during the last decade, Booz & Co. concluded that "insiders perform better and last longer…insiders have produced superior regionally market-adjusted shareholder returns in seven of the last 10 years." [2] However, a recent study conducted by Spencer Stuart in the Harvard Business Review found that, like many issues in business,



the circumstances facing the company must be taken into consideration. The Spencer Stuart study examined the pros and cons for internal and external CEO candidates and found that "insiders are best when the company is performing well; outsiders do better when the company is in crisis." [3]

Equilar's study of CEO turnover found that nearly three-quarters (73.0 percent) of the incoming CEOs were internal hires, meaning that they worked for the company prior to being appointed CEO. One quarter (24.9 percent) of the incoming CEOs were hired from outside of the company. At the remaining 2.1 percent of firms, a former CEO returned to re-take the reins.

CEO Gender

There has been much discussion recently about the lack of gender equality among the leadership ranks of large US companies. A March 2011 study by Catalyst found that while women comprise nearly half (46.7 percent) of the US workforce, they make up only 2.2 percent of the CEOs of Fortune 500 companies.[4]

An examination of the genders of departing and incoming CEOs in the study found some signs of change. While only 1.4 percent of the departing CEOs were female, 4.8 percent of the incoming CEOs were women. In fact, 17 companies in the study saw a male step down as CEO, to be replaced by a female. There were, however, two instances where a female CEO was the one departing and was replaced by a male CEO. There was only one company where a female CEO replaced another female CEO.

Company Founders

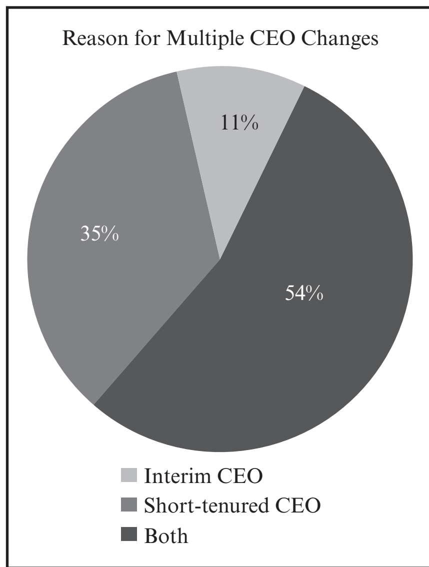
Thirty-five of the departing CEOs were founders of their companies. The departure of a company founder is often a test of the business strategy and the organizational structure developed by the founder. Is the company strong enough to continue successfully without the founder's day-to-day involvement?

Again, the person chosen to replace the founder plays an important role in the success of the transition. Replacing a company founder is often a challenge, which heightens the questions surrounding the decision to hire an internal candidate or look outside the company for the new CEO. Roughly three-quarters (74.3 percent) of the 35 founders that departed were replaced with an internal candidate, while the other 25.7 percent chose an outsider for the position. Notably, these percentages are similar to those found among the broader group of companies studied, meaning that the companies facing the departure of the founder were just as likely to hire an internal candidate as other companies replacing a non-founder CEO.

As noted above, incoming CEOs are typically younger than the executives they replace, and this pattern is even more apparent among companies where the founder stepped down from the CEO position. The median age of the departing founders was 63, while the median age of their replacements was 48. More notably, seven of the departing founders were age 70 or older, with the oldest being 88. The oldest replacement CEO was 64 years old.

Multiple CEO Changes

Equilar identified 48 companies which had more than one instance of CEO turnover from 2007 to 2010. This article presents the findings of an in-depth look at companies with more than one change in CEO during this period. In this analysis, these companies are classified into two categories: those that saw multiple CEO changes during the four-year period studied due to short CEO tenure(s) (i.e., shorter than three years), and those with an interim CEO in place during the timeframe studied. A handful of companies fell into both categories, with one or more CEO changes due to short tenure and one or more people serving as interim CEO between 2007 and 2010.



The Interim CEO Approach

It is widely accepted that the board should have an extensive succession plan in place, allowing a successor to be named to the CEO position regardless of the circumstances which led to the former CEO's departure. Recently, shareholders' calls for leadership succession plans to be disclosed have increased the need for boards to focus on this important issue. Although some believe that naming an interim CEO indicates the lack of an effective CEO succession plan, others argue that choosing an interim chief can be an effective approach, providing a firm with strong leadership as its board works to identify the best candidate to replace a departing leader. This situation, proponents agree, can be a lifeline in situations where the CEO's departure is unplanned or unexpected, as in cases of death or disability, scandal, or when the CEO is hired away by another company.

Equilar's study found that the most common circumstance leading to more than one CEO change taking place was the board's decision to name an interim CEO. In fact, nearly two-thirds (65 percent) of the companies in this study had an interim CEO at some point between 2007 and 2010. This analysis includes 32 interim CEOs from 31 companies (one company had two different interim CEOs during the timeframe studied).

Who Serves As Interim CEO?

Typically, the interim CEO is a top board member who steps in to assist the company through the leadership transition. For example, when the Chairman, CEO and President of Advance Auto Parts left in May 2007 "to pursue other business opportunities," the board's lead director stepped in and became interim CEO while the board conducted a search for a permanent chief executive. Similarly, when Walgreens' CEO retired, the board's lead director took over as "Chairman and Acting CEO" while the board searched for a permanent replacement.

Occasionally, it takes more than one person to lead the company in an interim capacity. At Pinnacle Entertainment, the departing Chairman and CEO was replaced by two board members on an interim basis: "Richard J. Goeglein has been named interim nonexecutive chairman and John V. Giovenco has been named interim chief executive officer. Messrs. Goeglein and Giovenco, both board members, will oversee the company's operations while the board conducts an executive search for a new president and chief executive officer." [5]

Even after a board chooses a permanent replacement, the executive might be under contract, precipitating the need for an interim CEO until the desired executive is free of obligations to another firm. When International Flavors & Fragrances' (IFF) Chairman and CEO left the company in September 2009, the person tapped to take over as Chairman and CEO – at the time a board member of IFF and the Chairman and CEO of another company – was still under contract with his current employer and could not assume the lead of IFF until that contract expired. So, he stepped into "the role of Non-Executive Chairman on October 1, 2009 and the positions of Chairman and CEO when his contract with his current employer expires no later than the end of first quarter 2010."While the

company waited for its new leader to become available, the board established a "temporary Office of the CEO, which will be comprised of three current IFF executives" including the CFO, and two Group Presidents.[6]

At a few companies in Equilar's study, the interim CEO was a former CEO and current board member who briefly resumed his or her former position when temporary leadership was needed. At the Great Atlantic and Pacific Tea Company, the former CEO stepped in on an interim basis when the CEO left in October 2009. According to the company's press release: "The Company has commenced a search for a successor and in the interim, Christian Haub, Executive Chairman of the Board, will reassume the Chief Executive Officer responsibilities, a position he previously held from 1998 until 2005."[7]

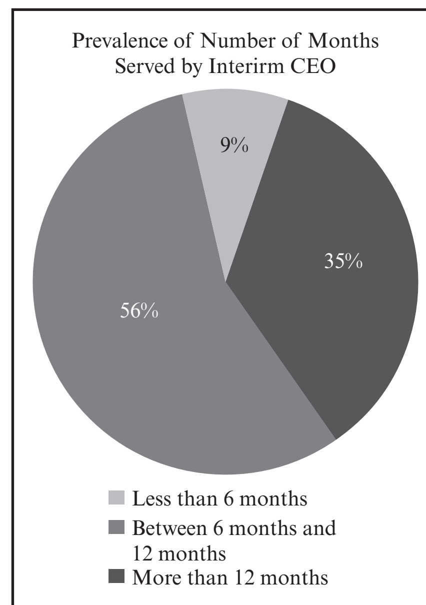
How Long is the Interim CEO in Place?

One important factor in the success of the leadership transition is the length of time the interim CEO serves. Usually, boards intend to have the interim CEO serve for a short period of time, until a permanent CEO is selected. In some cases, however, the search process drags on, leaving the interim CEO in his or her role much longer than planned. The company with the longest-serving interim CEO in Equilar's study was GenCorp, which had the same interim CEO in place from March 2008 to January 2010. However, the company maintains that his appointment as CEO "was never intended to be permanent."[8]

The chart shows that of the 32 interim CEOs studied, most served in the interim role between six and 12 months.

Short-Tenured CEOs

The other category of companies with multiple CEO turnovers includes those companies which had CEOs with short tenures (i.e., less than three years) during the timeframe studied.



Several of the companies with short-tenured CEOs made news headlines due to scandals or major leadership shake-ups. AIG was, and continues to be, the subject of intense media coverage, due to its role in the financial crisis and subsequent bail-out by the US government. AIG is one of the companies with the highest number of CEOs during the timeframe studied: since mid-2008, four different people have served as CEO of the company.

Other resignations may not have received the same level of notoriety, but nonetheless left companies facing an unplanned leadership change. At Arbitron, Michael Skarzynski became CEO as an external hire in January 2009 after the company's long-time Chairman, CEO and President stepped down from his CEO and President roles. In January 2010, another of the company's directors took over as CEO when Mr. Skarzynski resigned after making misstatements in Congressional testimony.[9]

Scandal isn't always the cause of a departure: firms often find themselves facing multiple changes in the CEO's office for reasons that have nothing to do with misbehavior. Sometimes the demands of the CEO role are too much for an executive to handle, causing him or her to leave the position after a short tenure. For example,

3Com CEO Scott Murray left after only seven months on the job, "finding the amount of time required to be in China to support the company's key partnership with Huawei to be too much of a time commitment away from his family."[10] In April 2010, 3Com was purchased by HP – another company with multiple CEO turnovers during the timeframe studied.

Conclusion

Whatever the reason, a change in CEO is a significant event for a corporation. When there are multiple changes in a short period of time, the impact on the company can be even greater. Having a comprehensive succession plan in place is a necessity to ensure a smooth transition whether the CEO's departure is planned or unexpected.

Notes

1. *See* "Crises Trigger Dramatic Departures" at: *http://online.wsj.com/article/SB100014240527487042597045760 33483108595762.html?KEYWORDS=CEO+Turnover*.

2. *See* " CEO Succession 2000-2009: A Decade of Convergence and Compression" at *http://www.booz.com/global/home/what_we_think/reports_and_white_papers/ic-display/49177763*.

3. *See* "Succeeding at Succession" at *https://archive.harvardbusiness.org/cla/web/pl/product.seam?c=7105&i=7107&cs=5933466214cd23f7888714d905a6fe07*.

4. *See* "US Women in Business" at *http://www.catalyst.org/publication/132/us-women-in-business*.

5. *See* "Pinnacle Entertainment Announces Executive Management Changes" at *http://www.smartbrief.com/news/aaaa/industryPR-detail.jsp?id=8944D12E-5CEE-4F1E-A30A-0C01671E6B42*.

6. *See* the company's September 19, 2009 press release at *http://ir.iff.biz/phoenix.zhtml?c=65743&p=irol-newsArticle&ID=1331288&highlight*.

7. *See* the company's October 20, 2009 press release at *http://www.aptea.com/pressRoom_article.asp?id=170*.

8. *See* "Neish Resigns from Aerojet, GenCorp" at *http://www.spacenews.com/launch/100106-neish-resigns-aerojet-gencorp.html*.

9. *See* "Morris Steps Down At Arbitron, Research/Radio Neophyte Tapped To Replace Him" at *http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=98141* and "Arbitron's Chief Resigns After a False Statement" at *http://www.nytimes.com/201%1/13/business/media/13arbitron.html*.

10. *See* at "3Com CEO exits after 7 months; former exec returns to take reins" at *http://www.networkworld.com/news/2006/080906-3com-murray-masri.html*.

Navigating the Waters of Special Meetings and Written Consent Proposals

By Shirley Westcott

Although executive compensation is the centerpiece of this year's proxy season, annual meetings are still replete with the usual docket of shareholder resolutions. High in the count, both in number and corporate frustration level, are proposals sponsored by gadfly activists John and Ray Chevedden, William and Kenneth Steiner and the Rossi family to expand shareholders' ability to take action between annual meetings via special meetings or written consent.

This year's vote tallies, however, point to two emerging trends on these proposals which may give companies a brief sigh of relief: (1) opinions of proxy advisors, particularly ISS, are having less of an impact on the vote outcomes, and (2) investors, like the corporate community, are growing weary of these resolutions.

This article offers insights regarding how written consent and special meeting proposals are shaping up this year and ways in which companies can approach them.

Special Meetings

This marks the fourth year of the proponents' exhaustive campaign to enhance shareholders' right to call special meetings. Even though many companies complied with earlier versions of the proposal and adopted a 25 percent ownership requirement for invoking this right, the resolutions continued to resurface seeking a further reduction to 10 percent.

According to data from SharkRepellent.net, only about half of S&P 1500 companies currently allow shareholders to call special meetings at all. Of these companies, 28 percent have a minimum ownership threshold of 10 percent (in part due to state laws), 26 percent have minimum ownership thresholds of between 15 percent and 25 percent (primarily 25 percent), and 46 percent have minimum ownership thresholds of 30 percent or more.

Investors want some ability to call special meetings, but their comfort level as to how far to extend this right has topped off somewhere between 15 percent and 25 percent. The proponents themselves are recognizing this. This year they are trying out different ownership levels in their submissions, particularly at companies where their 10 percent proposals failed last year: 15 percent at Boeing, Citigroup, Colgate-Palmolive, Home Depot, Interpublic Group, NV Energy and Verizon; 20 percent at American Express, Caterpillar and Waste Management; and 25 percent at McGraw-Hill. (The latter two were ultimately omitted.)

Proxy advisors ISS and Glass Lewis favor minimum ownership thresholds of 10 percent and 10-15 percent, respectively, though both state in their policies that they take into account other factors in reviewing shareholder resolutions on special meetings, such as the company's size, investor base, responsiveness to other shareholder matters, and current provisions for calling special meetings. In practice, ISS has supported all of the shareholder resolutions so far this year, as it did in 2010, irrespective of the minimum ownership level advocated in them. Statistics are not available on Glass Lewis's recommendations.

While companies should be aware of the proxy advisors' policies, their recommendations haven't swayed this year's votes on special meeting proposals. Of the 23 shareholder proposals where vote results have been reported to date, only three have received majority support: Citigroup and NV Energy (which both

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received the 15 percent proposal) and NYSE Euronext (which prohibits shareholders from calling special meetings). In contrast, 12 of the 43 shareholder proposals on ballots last year won majority support.

Companies are clearly better served by consulting their own investors in establishing the parameters for allowing shareholders to call special meetings. In addition to the minimum ownership requirement, companies should be mindful of other potential pitfalls:

Restrictive Provisions

This year over a dozen companies omitted the shareholder proposals by advancing their own resolutions to give shareholders greater ability to call special meetings, most often for holders of 20 percent or 25 percent of the shares. While these are passing handily, several companies have gotten caught in an ISS tripwire for including restrictive covenants in their certificate and bylaw amendments, such as limits on the timing and agenda of special meetings or mandates that the ownership requirement be met through a net long position.

ISS took issue with these provisions at Marathon Oil, Mattel, and Southwestern Energy and opposed their management proposals, but oddly didn't object when similar provisions were tucked into nine other companies' proposals this year. ISS also rejected a reincorporation proposal at Williams-Sonoma (May 25 annual meeting), until the company removed its restrictions relating to special meetings. So far, investors haven't shown disapproval of such procedural safeguards, or possibly they haven't noticed them. The proposals at Marathon Oil, Mattel, and Southwestern Energy all passed.

Repeat Majority Votes

Boards that fail to respond to shareholder proposals that receive majority support in multiple years face the prospect of high opposition votes to their reelection. However, regarding the issue of special meetings, shareholders appear to be more flexible than the proxy advisors as to what constitutes a satisfactory response. ISS, for example, expects companies to implement the letter of the proposal and this year recommended against the boards of Marathon Oil and Allstate for not adopting the proponents' 10 percent ownership threshold after two years of majority support, even though both companies proposed certificate and bylaw amendments to adopt 20 percent ownership requirements for calling special meetings. Despite the ISS recommendation, shareholders ultimately approved Marathon Oil's and Allstate's proposals and board reelection.

Written Consent

After a successful debut in 2010, the proponents are back in force this year with their companion proposals to allow shareholder action by written consent. Since many of these are resubmissions (12 of the 35 on ballots through June), targeted companies may need to start planning how to address any that receive majority support. Here are some factors to consider.

Complying with Proxy Advisor Policies

ISS and Glass Lewis largely support shareholder proposals to adopt written consent. Although ISS revised its policy this year to give companies credit for having a "low-risk, shareholder-friendly" governance structure, the hurdles are rigorous: an annually elected board, majority voting in director elections, no non-shareholder approved poison pill, and an "unfettered" right for holders of 10 percent of the shares to call special meetings. So far this year, the only companies that have met ISS's conditions for not supporting the shareholder proposal are Sempra Energy and Kohl's.

Adopting the Proposal

Relatively few companies allow shareholders to act by less than unanimous written consent (28 percent of the S&P 1500 according to *SharkRepellent.net*), because it can deny some shareholders the opportunity to be informed about and vote on the proposed business.

This year Home Depot is proposing to adopt written consent after a shareholder proposal received majority support in 2010. However, the company's articles contain a clearly delineated process to limit overuse and ensure adequate advance notice before any consent action may be taken. This includes requirements that holders of at least 25 percent of the shares must first request that the board set a record date to determine which shareholders are entitled to act by written consent, and that consents must be solicited from all shareholders. Although the proxy advisors have yet to weigh in on Home Depot's proposal, it may serve as guidance for other companies which decide to accord shareholders this right.

Gauging Shareholder Interest

As with the proposals on special meetings, shareholders appear to be backing off from written consent this year. Of the 24 shareholder resolutions where vote results have been reported to date, only eight have received majority support (at Alcoa, Allstate, Amgen, AT&T, CVS Caremark, International Paper, Liz Claiborne, and NYSE Euronext), compared to 13 out of 18 proposals in 2010.

Waning shareholder interest in written consent prompted Alaska Air Group to take a novel approach to the issue this year. After a 2010 shareholder proposal was supported by a majority of outstanding shares, the company consulted a number of its investors and found that 13 percent of those who supported the shareholder resolution last year would not do so again if it were resubmitted in 2011. On this basis, the company has decided to conduct an *advisory* vote at its May 17 annual meeting (which the board is recommending against) to reaffirm whether or not its shareholders want the ability to act by written consent.

Alaska Air's approach may present an alternative avenue for companies dealing with majority-supported shareholder resolutions on this issue and possibly others. Both ISS and Glass Lewis concluded that the company's advisory vote was an acceptable response to last year's shareholder referendum and, accordingly, refrained from recommending against the Alaska Air board. On the proposal itself, ISS (and ultimately shareholders) sided with the board's position against allowing written consent.

The New "Best Practices" Standard? Independent Legal Counsel for Compensation Committees

By Robert M. Fields

Today, shareholders are more willing than ever to hold corporate directors, especially those serving on compensation committees, to account for what many perceive as excess executive compensation. Although a few years old, the high-profile shareholder suit against the board of directors of the Walt Disney Company and Michael Ovitz remains as one of the seminal cases providing guidance with respect to the extent to which corporate directors can be held accountable for excessive compensation paid to corporate executives. In this context, Disney/Ovitz is still an important direction-setter.

While the Delaware courts ultimately ruled in favor of Ovitz and Disney's board, they certainly gave no ringing endorsement of the board's oversight practices, and corporate directors should not take much comfort in the outcome. In fact, had it not been for certain procedural matters, the ultimate decision may very well have been against Ovitz and Disney's board. Accordingly, many compensation committees took this decision as a wake-up call to revisit their policies for limiting potential legal exposure.

In this vacuum of uncertainty, one action that compensation committees can take is to engage the services of independent legal counsel instead of relying on in-house attorneys or general outside counsel. Congress' inherent encouragement of compensation committees to utilize independent counsel (*see* Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)) and the current uptick in executive pay (which will certainly generate reactions from corporate governance professionals as well as the general public), provide additional impetus for compensation committees to engage independent counsel.

Robert M. Fields is the Founder and Managing Partner of Law Offices of Robert M. Fields.

The Compensation Committee's Role on the Board

A compensation committee's principal duty is to determine the amount and form of compensation for the CEO and other senior executives. To accomplish this, the committee, with the assistance of a compensation consultant and legal counsel:

- Determines, by reference to comparables and other indicia, the proper level of base salary to be paid to the CEO and other senior officers, as well as the type and amount of perquisites.

- Chooses the amount and types of incentive pay for senior executives, including cash, stock options, stock appreciation rights, restricted stock, restricted stock units, etc.

- Sets the goals, targets and other metrics to be utilized in determining whether incentive pay is earned below, at or above the target level.

- On an annual basis, evaluates, on both an objective and subjective level, the performance of the CEO and certain other senior executives and determines the degree by which the goals, targets and other metrics are, or are not, satisfied.

- In light of past executive and corporate performance, evaluates the effectiveness of different forms and levels of incentive pay, as well as of the goals, targets and other metrics used in the past.

- Negotiates compensation packages and employment contracts with the CEO and

other senior executives as well as change in control benefits, severance benefits and other post-employment programs.

- Lastly, the compensation committee reviews the Compensation Discussion and Analysis prepared by management and makes recommendations, in its Compensation Committee Report, as to whether it is to be included in the corporation's annual report.

On a broader spectrum, the compensation committee also works with the compensation consultant and outside counsel in designing and implementing equity and other incentive plans that may be applied company-wide, approves the adoption of, and amendments to, the company's qualified and non-qualified retirement plans and sets director compensation and perquisites.

Best Practices for Compensation Committees

Clearly, compensation committees and other board members have the greatest chance of satisfying the requirements of the fiduciary duty of "due care" and, accordingly, enjoying the protection of the business judgment rule, if they adopt and utilize certain "best practices" in the process of carrying out their duties. These best practices have traditionally included: (i) giving the members of the compensation committee adequate notice of the matters to be discussed at forthcoming meetings so that they have time to review all appropriate documentation and marshal their thoughts prior to the meetings, (ii) setting aside sufficient time at the meetings for the members of the committee to ask questions of their compensation experts and of each other and to engage in substantive deliberations of the matter at hand, (iii) giving the members of the committee sufficient time for final consideration and vote (preferably at a follow-up meeting), and (iv) keeping detailed and accurate minutes of the discussions engaged in at the meetings.

Section 952 of Dodd-Frank essentially encourages an enhancement of these best practices by imposing new independence requirements on board compensation committees, legal counsel and compensation consultants. SEC regulations to be promulgated under Section 952 will ensure that the new rules established under Section 952 give compensation committees the ability to truly operate independently of corporate management. As substantial compensation committee independence would ultimately benefit corporate stockholders and the public at large, adhering to the intent of this new law is crucial to a corporation's obtaining the public's acceptance of, and trust in, its compensation programs.

Specifically:

- Section 952 requires that compensation committees be independent of corporate management; and

- Section 952 also requires that, in order to better insure compensation committee independence, legal counsel and other compensation advisors may be engaged by compensation committees only after certain indicia of independence are taken into account.

The SEC is currently considering alternatives to how it can effectively enforce the requirements of Section 952. One route that it may take is to require listed issuers (either by SEC Final Rules or stock exchange listing standards) to disclose in their proxies (or other public documents) whether their compensation committees have elected to utilize independent counsel and compensation consultants. If not, companies may then be required to describe the reasons why such action was not taken.

A public disclosure that a corporation has not elected to take all steps necessary to ensure compensation committee independence will most certainly have a negative effect on the corporation's relationship with its stockholders and may even result in a recommendation by Institutional Shareholder Services and similar organizations that stockholders oppose the committee's and management's executive compensation initiatives. Clearly, the logical choice for compensation committees is to make the

engagement of independent counsel and compensation consultants a standard practice.

Why the Need for Independent Counsel?

Why is having independent legal counsel important to effectively engage in best practices? By attending at least four compensation committee meetings per year (or more frequently as needed) and being available throughout the year to advise on any issues that arise, independent counsel can assist compensation committees on (i) procedural requirements to satisfy the business judgment rule so committee members can effectively insulate themselves from shareholder derivative actions, (ii) interfacing with compensation consultants and facilitating effective communication by suggesting areas of focus, (iii) reviewing and commenting on the compensation provisions of proxy statements, (iv) the committee's compliance with the requirements of tax and securities laws; and (v) drafting and revising compensation committee charters.

Independent counsel can best handle this role since the corporation's general outside lawyers may not be completely unbiased as to compensation issues due to their relationship with the CEO and other senior officers. Independent counsel is especially necessary when the company enters into compensation/contract negotiations with the CEO or senior executives. In-house counsel may not want to negotiate against their future superiors and general corporate counsel may not have sufficient independence. Lastly, independent counsel can best work with the corporation's compensation consultant in giving totally unbiased opinions and advice as to the propriety of various levels and types of compensation. By definition, independent counsel should have no underlying agenda to curry favor with corporate executives.

It is important to note that independent legal counsel can supplement, and not necessarily replace, a compensation committee's ongoing relationship with general corporate counsel and compensation consultants. He or she will provide independent, substantive input on various key issues, yet work with compensation consultants, general outside counsel and in-house attorneys to effectively develop reasonable and sound executive compensation programs and policies. The additional "pair of eyes" provided by independent counsel will result in synergies in the development of new ideas and concepts.

By engaging independent legal counsel, compensation committees can make "clean" proxy disclosures, because, as mentioned, new SEC Rules and/or exchange listing standards will likely require the compensation committees to disclose whether or not they have engaged independent counsel. Indeed, by having independent counsel sign off on potentially controversial actions (such as severance packages for departing executives) compensation committees can effectively mitigate adverse publicity.

What Will Compensation Committees Be Doing?

An informal survey of attorneys, HR officers, board members and compensation consultants taken by the author shows that more than 50 percent of companies surveyed intend to use independent legal counsel in the future if the proxy disclosure described above becomes mandatory. This is especially true of government contractors, financial institutions, insurance companies, and corporations that have experienced compensation-related controversies in the past, all of which are highly sensitive to public and governmental opinion and, thus, are very careful to avoid any adverse proxy or other public disclosures.

Conclusion

The issue as to whether board compensation committees are going far enough to satisfy the investing public remains very much alive. Smart companies are moving toward enhanced best practices, including the utilization of independent counsel for their compensation committees, in order to further inoculate themselves from adverse litigation.

Comply-and-Explain: Should Directors Have a Duty to Inform?

By John Wilcox

"Can we end the long tradition of the boardroom as a sealed chamber from which we issue only unanimous endorsements of management's actions and results? Can we move toward more transparency about the boardroom process, without undermining the ability of management teams to produce the results that shareholders want?" [1]

A new "Directors' Duty to Inform" could be derived from the "Standards of Conduct for Directors" in section 8.30 of the Model Business Corporation Act (MBCA).[2] To fulfill their duty to inform, directors of publicly held companies would be obligated to explain to shareholders how they are discharging their duties in a manner they "reasonably believe to be in the best interests of the corporation."[3]

A duty to inform would have five main objectives:

1. Explain the relationship between the board's governance decisions and the company's business goals;

2. Enable shareholders to make an informed evaluation of

   A. the company's governance,

   B. the directors' competence and independence, and

   C. the board's exercise of business judgment;

3. Enhance directors' credibility through the articulation of

   A. the processes by which board decisions are made, and

   B. the strategic rationale for their decisions;

4. Encourage customization, flexibility, and strategic focus in boards' corporate governance practices comparable to the "comply or explain" approach used in principles-based governance systems; and

5. Promote dialogue and reduce confrontation between boards and shareholders.

The substantive information provided by directors pursuant to a duty to inform would be

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company-specific, qualitative, contextual and forward-looking, thereby bringing it within the protection of the business judgment rule. The intent of the duty would not be to increase directors' liability, but to increase their accountability to shareholders.[4]

The duty could be discharged by means of a written annual "Directors' Discussion and Analysis" or by periodic communications from board committees or the board chair to the shareholders.

The expected long-term impact of a duty to inform would be to "operationalize" corporate governance policies and accustom boards to provide greater transparency about their deliberations and decisions on matters relating to governance, business oversight, and strategy.

Regardless of whether a directors' duty to inform can be inferred from the MBCA or other provisions of state law, it could be implemented through the adoption of a charter or bylaw amendment initiated by the board or by shareholders.

The Problem: Shareholders Need to Observe and Understand Board Conduct

Nell Minow, editor and co-founder of The Corporate Library, has famously said: "[B]oards [of directors] are like subatomic particles—they behave differently when they are being observed..."[5]

The key words in Minow's statement are "observed" and "behave." From the perspective of long-term investors, corporate governance is primarily a means to observe and monitor the behavior of directors, who are the shareholders' elected representatives, and to influence their behavior when necessary. The simple presumption behind most governance reforms is that directors will act with greater care and diligence when they are effectively monitored and accountable for their decisions. This presumption is a matter of human nature rather than law.

Given the goal of improved observation, a major governance dilemma arises because the boards of US companies conduct their deliberations and make their decisions behind closed doors. Even though two decades of governance reforms have expanded companies' disclosure requirements and amplified the duties and responsibilities of directors, boardroom windows at US companies remain closed, with shades down and curtains drawn.

Corporate advocates in the United States vigorously defend boardroom privacy on grounds of collegiality, competitiveness, independence, and respect for directors' expertise and business judgment. However, boardroom secrecy and constraints on communication create problems: they can polarize relations between directors and shareholders, forestall dialogue, undermine trust, reinforce adversarial forms of engagement, and impose substantial costs on both companies and shareholders.

For companies, the primary costs of board secrecy involve the time and resources boards must devote to formal compliance with governance rules, disclosure requirements, and shareholder engagements—not to mention the legal, lobbying, and public-relations dimensions of these activities. Shareholders, particularly institutional investors, incur comparable costs in their governance advocacy, monitoring of portfolio companies, engagement campaigns, activism and promotion of shareholder rights—not to mention the losses incurred when poor governance practices cause the value of portfolio companies to decline.

In addition to imposing these systemic costs, board secrecy and adversarial relations between companies and shareholders have contributed to the rise of a proliferating industry of corporate-governance experts, proxy-advisory firms, governance-rating entities, proxy solicitors, consultants and intermediary service providers. The demand for the services of these firms has grown rapidly during the past two

decades in parallel with increases in governance regulation and shareholder activism. At this point, there is every reason to think that the costs and resource demands associated with these activities will continue to grow in the aftermath of the financial crisis and the new Dodd-Frank regulatory regime.[6]

Even though shareholders have achieved a largely unbroken record of success in promoting governance reforms, it is becoming increasingly clear that there is a limit to the effectiveness of prescriptive rules and external metrics. The financial crisis demonstrated all too clearly that compliance with rules and best practices does not ensure good governance. In some high-profile cases, companies' full compliance with governance norms did little more than provide cover for weak board oversight, incompetence, and fraud.

In this skeptical post-crisis environment, new strategies are needed to ensure that boards are not just compliant, but are implementing governance effectively. These strategies must come from within the boardroom. Although shareholders will continue to demand greater transparency and accountability, a window into the boardroom can be opened only by the directors. Boards must act on their own initiative, not just in response to more disclosure requirements and governance rules.

Potential Sources of the Duty to Inform

A. The Model Business Corporation Act

The MBCA is a logical place to focus the search for the fundamentals of a directors' duty to inform. Section 8.30 of the MBCA sets forth the "Standards of Conduct for Directors."[7] The operative language in section 8.30(a) states: "Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation."[8]

The comment to section 8.30(a) explains: "The phrase 'best interests of the corporation' is key to an explication of a director's duties. The term 'corporation' is a surrogate for the business enterprise as well as a frame of reference encompassing the shareholder body."[9]

In essence, the MBCA confirms the common understanding that directors have a duty to act in the best interests of the company and its shareholders. From both corporate and shareholder perspectives, the purpose of corporate governance should be to support this principle that aligns the interests of shareholders with the economic success of the business enterprise.

The generic MBCA Standards of Conduct for Directors are supplemented by the language in section 8.30(c), which requires a director to "disclose . . . to the other board or committee members information not already known by them but known by the director to be material to the discharge of their decision-making or oversight functions."[10] The comment describes this standard as "a duty of disclosure among directors."[11]

Although section 8.30(c) defines a limited reciprocal duty among board members, it could be recast to serve as a template for a directors' duty to inform. Substitution of the word "shareholders" for the words "other board members" in section 8.30(c) would transform and broaden the duty to "encompass the shareholder body." With this textual revision, the new version of section 8.30(c) would read as follows: "In discharging board or committee duties a director shall disclose, or cause to be disclosed, to the shareholders information not already known by them but known by the director to be material to the discharge of their decision-making or oversight functions..."

Under the revised language, the phrases "not already known by them" and "their decision-making or oversight functions" would refer to the shareholders rather than the directors. If Nell Minow's observation is correct, this simple change of wording would effect a radical transformation in boardroom behavior by exposing

directors' decision-making to closer observation by shareholders.

Corporate directors have not traditionally been responsible for determining what information is material to their shareholders' "decision-making or oversight functions." Disclosure requirements under federal and state law have led companies to focus on materiality with respect to shareholders' investment decisions, not their administrative functions. Nevertheless, from the perspective of corporate governance, there are compelling reasons for expanding the board's standards of conduct under section 8.30 to address the duties and responsibilities of shareholders that are analogous to those of corporate directors.

Like corporate directors, many institutional investors, financial intermediaries and other trustees are fiduciaries. Under the Employee Retirement Income Security Act of 1974, the Department of Labor has long regarded the exercise of proxy votes as a fiduciary duty of pension trustees and their designated investment managers.[12]

As fiduciaries acting on behalf of beneficial owners, the "decision-making and oversight functions" of investors include voting proxies and electing the directors of portfolio companies. A persuasive argument can be made that in order to discharge their fiduciary duty to vote shares and elect directors in an informed manner, investors should have access to "material... information not already known to them" about the conduct of portfolio companies' directors and their discharge of the duties set forth in section 8.30.[13] A directors' duty to inform would provide this information to shareholders.

B. The Corporate Director's Guidebook

The Corporate Director's Guidebook, developed by the American Bar Association Committee on Corporate Laws, is another logical source for understanding and interpreting board duties.[14] Section 3 of the Corporate Director's Guidebook sets forth the "Responsibilities, Rights and Duties of a Corporate Director." Section 3.C.4 describes as one of the "legal obligations" of a corporate director a "duty of disclosure" that comes close to the concept of a duty to inform, but falls short in several ways.[15]

Section 3.C.4 states: "As fiduciaries, directors have an obligation to take reasonable steps to ensure that shareholders are furnished with all relevant material information known to the directors when they present shareholders with a voting or investment decision."[16] The emphasized language limits the duty by aligning it with disclosure requirements that exist under federal securities laws and narrowing the context to situations that involve specific action by shareholders. It does not establish a general continuing duty to inform shareholders about board processes and conduct.

Section 3.C.4 also mentions that some courts have expanded the board's duty of disclosure beyond circumstances involving shareholder action: "[E]ven where the directors are not recommending shareholder action, they have a duty (independent of disclosure obligations generally under the federal securities laws) not to mislead or misinform shareholders."[17] This interpretation is helpful in its acknowledgement that the state law duty of disclosure is independent and separate from federal disclosure requirements. However, it describes the duty in negative terms as an obligation "not to mislead or misinform shareholders," rather than asserting an affirmative duty to provide shareholders with information that is material to their evaluation of directors' conduct and business judgment.

Directors' "disclosure" and "transparency" duties should be distinguished from the duty to inform in order to reinforce the qualitative differences in information communicated by a board at will rather than pursuant to a legal mandate. The duty to inform should not set limits, or dictate information that is deemed to be material, or mandate specific disclosures. Instead, the duty should encourage open communication in the form of a narrative that tells the story of a board's decision-making processes and the strategic rationale for its choices in the

context of the individual business enterprise. The substance of the narrative should be based on the judgment of the directors, not dictated by compliance requirements.

C. The U.K. Governance System: Comply-or-Explain

By definition, a duty to inform would confer broad discretion on directors to explain how they discharge their duties in a manner they "reasonably believe to be in the best interests of the corporation." The duty would introduce a do-it-yourself dimension to boards' corporate governance programs that would be largely voluntary and self-administered. The duty would not be administered by a regulator (as the Securities and Exchange Commission (SEC) regulates shareholder proposals under Rule 14a-8).[18] It would not be enforced by a self-regulatory organization (SRO) (as the New York Stock Exchange enforces listed company standards with the threat of delisting).[19]

It would generally involve decisions protected by the business judgment rule and would therefore not be subject to the "Standards of Liability" defined in section 8.31 of the MBCA (although it would certainly be subject to federal and state antifraud provisions). In lieu of these traditional methods of oversight and enforcement, the duty to inform would be based on directors' accountability to shareholders.

The best-known model for accountability-based governance is the comply-or-explain program that has been in operation in the United Kingdom for nearly two decades.[20] Although not without its critics, the United Kingdom's voluntary comply-or-explain governance regime offers a number of advantages for companies. Comply-or-explain is specifically designed to promote flexible and customized governance practices rather than prescriptive rules and check-the-box compliance.

It gives deference to the knowledge, expertise, and judgment of corporate directors. It assumes that boards are best positioned to determine what specific information is relevant to an explanation of non-compliance. It assumes that directors will be candid and avoid boilerplate. Most importantly (and perhaps aspirationally), it assumes that institutional investors will be diligent in committing time and resources to evaluate the quality of a company's governance decisions in the context of business strategy and financial performance.

The UK Corporate Governance Code does not explicitly define a directors' duty to inform, but it mandates an open relationship and constructive dialogue between directors and shareholders. Section E of the UK Code states the following "Main Principle": "There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place."[21] The important principle at the heart of the UK Code is that the board itself must assume responsibility for dialogue with shareholders, rather than vice versa. This approach is in contrast with US practice, which discourages communication from boards to shareholders and encourages shareholders to initiate dialogue, usually through adversarial forms of engagement.[22]

The UK Code's provision E.1.2 further requires: "The board should state in the annual report the steps they have taken to ensure that the members of the board, and, in particular, the non-executive directors, develop an understanding of the views of major shareholders about the company..."[23] Again, the point is that with UK companies, the board has a direct role in outreach and dialogue with major shareholders in order to understand their views.

Comply-and-Explain: A Hybrid Governance Proposal

A directors' duty to inform modeled on the United Kingdom's principles-based, comply-or-explain system would pose challenges for US companies. It is unclear whether state law could accommodate a board duty defined with such broad discretion and enforced primarily by

means of shareholder accountability. Such a duty would occupy uncharted middle ground between the Standards of Conduct for Directors under section 8.30 of the MBCA and the Standards of Liability under section 8.31 of the MBCA. It is equally unclear whether the US rules-based system of corporate governance could tolerate a principles-based, discretionary approach to directors' duties and standards of conduct.

The success of a hybrid comply-and-explain governance system—grafting a new duty to inform onto the existing state and federal regulatory structure—would depend on two developments that are highly uncertain: (1) directors of US companies would have to overcome their habitual antipathy to shareholders, assume a less-defensive posture, and accept primary responsibility for dealing with shareholder concerns related to governance and board conduct; and (2) institutional investors would have to give priority to their responsibilities as long-term owners, commit resources to the oversight of portfolio companies, and reduce their dependence on standardized third party governance analyses and proxy-voting recommendations.

In addition to these legal, structural, and cultural problems, the directors' duty to inform would be likely to encounter resistance from US companies and directors already overwhelmed by compliance requirements and facing additional controversial governance pressures including: the majority-vote standard in director elections, shareholder access, say-on-pay, risk oversight, takeover threats, conflicts of interest, short-termism, empty voting, proxy mechanics, environmental and social policies, and financial-system reform.

Ironically, the imposition of a directors' duty to inform could actually help companies anticipate and avoid many of these contentious issues. A board-level narrative describing the decision-making process and explaining the context and business rationale for board decisions would help defuse shareholder concerns, reduce confrontation, and ultimately strengthen shareholder support even when there is a perception of non-compliance.

Executive compensation is a useful example that reveals the limits of disclosure rules and the need for better communication about board processes and policies. The say-on-pay movement grew out of shareholder frustration not only with perceived compensation excesses, but also with standardized disclosures that failed to address important strategic questions.[24]

The goal of an advisory vote is not to micromanage compensation but to increase board accountability and thereby compel directors to align pay with performance and explain how their compensation policies support business strategy and value creation. Through the exercise of a duty to inform, directors would have greater discretion to provide a comprehensive Board Compensation Committee Report explaining their compensation philosophy, their decisions with respect to bonus and variable pay, and the economic goals that the incentives are designed to achieve.

This approach would be more effective than attempting to shoehorn the board's views into the disclosure matrix of the management Compensation Disclosure and Analysis, or waiting to be targeted by shareholders and producing an explanation of directors' policies and decisions after-the-fact.

Towards Reciprocity: An Investors' Duty to Inform?

Imposition of a directors' duty to inform would not by itself result in "a dialogue with shareholders based on the mutual understanding of objectives."[25] Opening boardroom windows would help, but for interests to be fully aligned, institutional investors must also agree to comparable standards of candor and openness. Constructive dialogue between boards and shareholders must be a two-way street.

Debate over the Dodd-Frank bill launched a discussion of investor responsibility and fiduciary duty in the context of the abuses, conflicts of interest, and governance failures within the financial community that led to the crisis. As

financial-system reform unfolds in the United States under the new law, many experts believe that institutional investors will replace companies and directors at the center of the governance-reform spotlight.[26] Indeed, on October 21, 2010, the United States Department of Labor announced a proposed rule that would substantially strengthen the Employee Retirement Income Security Act (ERISA) definition of a "fiduciary."[27] More reforms are sure to follow.

Discussion of investor responsibility is already well under way in the United Kingdom, where the Financial Reporting Council adopted a Stewardship Code for institutional investors in July 2010.[28] It was preceded by an earlier Code on the Responsibilities of Institutional Investors, drafted in November 2009 by the Institutional Shareholders Committee, a forum representing major UK institutional investors.[29]

These efforts may prove useful as a precedent for a US private-sector initiative bringing together both corporate and investor representatives to deal with the conjoined issues of board and investor conduct.

Conclusion

Well before the financial crisis, Leon Panetta suggested that companies should open the "sealed chamber" of the boardroom and provide greater transparency about board processes. Instead, boardroom windows remained closed and US governance continued to pursue its traditional course of confrontation, legislation and rule-making.[30] Now, as companies stagger under the burden of compliance and face additional governance challenges in the Dodd-Frank Act, directors should seriously consider whether their sealed chamber is a privilege or a constraint and whether its growing costs outweigh its diminishing benefits.

The recent turmoil in the economy and financial markets underscores the importance of corporate governance and directors' accountability to shareholders. However, in the United States, there is currently no basis for establishing a directors' duty to inform shareholders about boardroom deliberations and governance decisions.

Section 8.30 of the MBCA requires directors to act in the best interest of the company and establishes a duty to inform other board members of information material to their decision-making function, yet it stops short of applying that standard to shareholders and investors. The Corporate Director's Guidebook limits directors' affirmative duty to inform shareholders in situations involving specific actions.

The UK Code presents a more open model of communication under the voluntary comply-or-explain system, fostering flexibility and deference to business judgment. However, by requiring explanation primarily when the board chooses not to comply, the UK Code still presents a level of communication short of the ideal.

A new duty to inform based on the principles of comply-and-explain would encourage directors of US companies to articulate how decisions made in the boardroom advance strategic goals and align with shareholder interests. It would preserve directors' discretion in the exercise of business judgment while providing shareholders with greater understanding of board conduct. In Panetta's words, a directors' duty to inform would "move toward more transparency about the boardroom process without undermining the ability of management teams to produce the results that shareholders want."[31]

Under a comply-and-explain system, directors would have to overcome the inertia of a traditionally opaque and defensive posture, while investors would be under an obligation to embrace their oversight function and use their voice and votes to hold directors accountable. If directors and shareholders would both commit to such reciprocal duties, improvements in transparency, accountability, and corporate stability would surely result.

Notes

1. This article was originally published in the journal of *Law and Contemporary Problems*. All citations and

references to this article should be cited in the following manner: John C. Wilcox, *Comply-and-Explain: Should Directors Have a Duty to Inform?*, 74 Law and Contemp. Probs. 149 (Winter 2011). The article is also available on the Web site of *Law and Contemporary Problems* at http://www.law.duke.edu/journals/lcp/. Leon Panetta, *It's Not Just What You Do, It's the Way You Do It*, Directors & Boards, Winter 2003, at 17, 21. For a general discussion of the problems of board–shareholder communication at U.S. companies, see generallySymposium, *Who Speaks for the Board?*, Directors & Boards, Second Quarter 2010, at 18; Comm. on Corporate Laws of the ABA Section of Bus. Law, Report on the Roles of Boards of Directors and Shareholders of Publicly Owned Corporations, *available at* http:*//www.abanet.org/media/nosearch/task_force_report.pdf*; *see also* Stefan Stern, *Investors Want You to Tell a Better Story*, Financial Times.com (May 31, 2010), *http://www.ft.com/cms/s/0/c3bcd18e-6cdb-11df-91c8-00144feab49a.html*.

2. Model Bus. Corp. Act § 8.30 (2008).

3. *See id.* § 8.30(c) (This section obliges directors to act in accordance with their reasonable beliefs about the best interests of the corporation, but it does not require that they communicate these beliefs to the shareholders).

4. The liability for selective disclosure prohibited by Regulation FD under the Securities Exchange Act could be avoided by limiting the topics covered by a duty to inform. See the discussion in Comm. on Corporate Laws, *supra* note 1, at 11 n. 24.

5. The Prime of Ms. Nell Minow (A CFO Interview), CFO Magazine, Mar. 2003, at 56, 62.

6. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

7. Model Bus. Corp. Act § 8.30 (2008).

8. *Id.* § 8.30(a) (emphasis added).

9. *Id.* § 8.30 cmt. 1 (emphasis added).

10. *Id.* § 8.30(c).

11. *Id.* § 8.30 cmt. 3.

12. Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, Dep't of Labor, to Helmut Fandl, Chairman of the Ret. Bd. of Avon Prods., Inc. (Feb. 23, 1988), *reprinted in* Council of Institutional Investors, Everything You Always Wanted to Know About Proxy Voting But Were Afraid to Ask 14–16 (2007), *available at http://www.cii.org/UserFiles/file/ resource%20center/publications/Proxy%20Voting%20Primer.pdf*; *see also* Interpretive Bulletins Relating to the Employment Retirement Income Security Act of 1974, 29 C.F.R. § 2509.94-2 (1994); Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 29 C.F.R. § 2509.08-2 (2008).

13. Model Bus. Corp. Act § 8.30 (2008).

14. Comm. on Corporate Laws of the ABA Section of Bus. Law, Corporate Director's Guidebook (5th ed. 2007).

15. *See id.* at 26.

16. *Id.* (emphasis added).

17. *Id.*

18. Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2010).

19. N.Y. Stock Exch., Listed Company Manual § 802.1D (2009), *available at* http:// nysemanual.nyse.com/LCM/.

20. *See* Fin. Reporting Council,The U.K. Corporate Governance Code (2010), available at *www.frc.org.uk/documents/pagemanager/Corporate_Governance/UK%20Corp%20Gov%20Code %20June%202010.pdf* [hereinafter U.K. Code]; see also James Hamilton, UK Reaffirms Comply or Explain Model for Corporate Governance as Financial Crisis Roils, CCH Financial Reform News Center (Aug. 28, 2009), *http://financialreform.wolterskluwerlb.com/2009/08/uk-reaffirms-comply-or-explain-model-for-corporate-governance-as-financial-crisis-roils.html* (The comply or explain approach has been in operation since the Code's beginnings in 1992 . . . and the flexibility it offers is valued by company boards and by investors in pursuing better corporate governance.).

21. UK Code, *supra* note 20, § E.1, at 25.

22. *See* Symposium, Who Speaks for the Board?, supra note 1.

23. UK Code, *supra* note 20, § E.1.2, at 25.

24. *See, e.g.*, TIAA-CREF, 10 Questions for Evaluating CD&A's (July 2007), available at *http://www.shareholderforum.com/op/Library/20070822_TIAA-CREF.pdf*.

25. UK Code, *supra* note 20, § E.1, at 25.

26. For further discussion on the evolving role of investors, see generally the recent publications of Bogle Fin. Mkts. Research Ctr., *www.vanguard.com/bogle_site/bogle_home.html*; *see also* John C. Bogle, Founder & Former Chairman, Vanguard Grp., Building a Fiduciary Society Remarks at the IA Compliance Summit (Mar. 13, 2009), *available at http://www.vanguard.com/bogle_site/ sp20090313.html*.

27. Definition of the Term "Fiduciary", 75 Fed. Reg. 65,263 (proposed Oct. 21, 2010) (to be codified at 29 C.F.R. pt. 2510).

28. Fin. Reporting Council, The U.K. Stewardship Code (2010), available at *www.frc.org.uk/images/uploaded/documents/UK Stewardship Code July 20103.pdf*.

29. Institutional S'holders Comm., Code on the Responsibilities of Institutional Investors (2009), available at *http://institutionalshareholderscommittee.org.uk/sitebuildercontent/ sitebuilderfiles/ISCCode161109.pdf*.

30. Panetta, *supra* note 1, at 21.

31. *Id.*

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