

Serving on the Board of a Public Company: Roadmap for Directors

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Investor activism and government regulation have forced public companies to publicly describe and defend the merits of their Board leadership structure and the qualifications of individual directors. Directors can enhance their service to the Board by monitoring developments in corporate governance.

Monitoring Director Independence

Public companies document director independence at least once a year using Director and Officer Questionnaires. Changes can arise during the year that might affect a director's independence or require proxy disclosure—for example, a director's immediate family member might marry a partner in the company's audit firm or participate in an investment banking engagement. In addition, as a result of changes in the rules of the Securities and Exchange Commission (SEC), more detailed public disclosures are required in the company's proxy statement of "transactions, relationships or arrangements" that were considered by the Board of Directors in determining that a director is independent.

Independent directors can ensure they meet Board independence standards by:

- Disclosing relevant information on the annual D&O questionnaire so that the Board can document the director's independence.
- Monitoring the director's independence on an ongoing basis between the annual D&O questionnaires, including relationships and arrangements entered into by immediate family members (and family marriages), and providing prompt updates to the general counsel regarding any transactions, relationships or arrangements that may compromise director independence.

Enhancing Performance of the Board of Directors

The Board of Directors and Board committees of listed companies conduct an annual self-evaluation to enhance the company's governance. Through the annual self-evaluations, a director can enhance Board performance by:

- Proposing enhancements, if appropriate, in the quality of information provided to the Board of Directors in advance of meetings.
- Involving legal counsel in the annual self-evaluation to protect any legal privilege that may apply.
- Working with the other members of the Board of Directors to implement governance changes identified through the self-evaluation.

Protecting Legal Privilege

Legal privilege is waived if privileged information is inadvertently communicated to third persons, with the result that the information can be used by plaintiffs against the company in future legal proceedings. In some internal investigations or shareholder litigation, legally privileged information may be restricted to a small group of independent directors acting as an independent committee of the Board of Directors.

A director may assist in protecting legal privilege in the following ways:

- Take steps advised by the general counsel to protect legal privilege from waiver in the course of deliberations of the Board of Directors and committees, whether through Board materials, notetaking or electronic communications.
- Ask financial advisers and accountants to step out of meetings of the Board of Directors when advised by legal counsel, and avoid any privileged discussions in the presence of these outside advisers and representatives.

Maintaining Confidentiality

Public companies safeguard confidential information to protect competitively sensitive information, avoid premature disclosure of confidential transactions, observe “quiet periods” under securities laws, protect legal privilege and comply with restrictions on selective disclosures to analysts and investors, and for other reasons.

- Directors can maintain confidentiality of Board deliberations by avoiding discussions outside the boardroom—especially in elevators, reception areas and airports—and by carrying Board papers in folders or briefcases.
- During merger negotiations and sensitive internal investigations, even the fact of holding Board or special committee meetings may be confidential from company employees as well as outsiders. For confidentiality reasons, business casual attire may be recommended by company counsel for weekend meetings.
- Directors are subject to the SEC’s Regulation FD, the rule against selective disclosure of material nonpublic information to analysts and investors. Directors should refer questions to the general counsel or investor relations to avoid selective disclosures.
- Directors have a duty to protect confidential news about upcoming mergers, operating results or technical developments such as clinical drug trials, as this information may be used by others to give them an unfair trading advantage. “Tipping” is illegal even when the insider does not trade.

M&A

In most large business combinations, the company will make an antitrust filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act). In connection with the HSR filing, the company must provide any “4(c)” documents, including studies, surveys,

analyses and reports which were prepared by or for any officer or director for the purpose of evaluating or analyzing the merger with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets.

- Directors should anticipate that any notes taken around the time of the merger (including informal notes on napkins and the like) will be gathered by company counsel and provided to the government as 4(c) documents.
- Overstated “puffery,” expansive references to dominating a market as a result of the merger, or references to creating market leadership positions in particular areas are seen by the government as problematic under the HSR Act. Directors should seek advice of counsel regarding Board communications, PowerPoint presentations, reports or deliberations in the M&A context.

Planning for Reelection

Incumbent public company directors have historically been reelected by large votes, except during active proxy contests. Votes for directors declined significantly with the end of discretionary voting by brokers at the annual meetings of shareholders. Increasing use of electronic proxy statements and online voting also reduced vote totals for directors.

Activist investors increasingly scrutinize the independence and conduct of directors, especially members of the compensation committee who approve stock awards for senior management, and may withhold votes for particular directors or committee members.

For companies with majority voting for directors, some directors may not be reelected as a result of “withhold” or “vote no” campaigns, even if there is no proxy contest. Many companies with a majority voting standard for directors now require a director to agree to resign if the director is not reelected by majority vote at the annual meeting of shareholders.

- Directors should inform themselves of the governance standards adopted from time to time by ISS, other governance organizations and the company's principal institutional shareholders, and receive briefings from the Board's nominating committee and company counsel.
- Public companies seek to maximize the company's governance quotient and communicate effectively with ISS and other proxy advisers.
- Each director should take appropriate steps in order to avoid a possible negative recommendation by ISS.

Communicating with Stockholders

The proxy rules of the SEC require a company to forward communications from stockholders to members of the Board of Directors.

Some public companies arrange meetings between members of the Board of Directors and significant shareholders as a venue to hear shareholder concerns. Any meetings with investors must comply with Regulation FD, the rule against selective disclosure of material nonpublic information to investors.

Oversight of Business Risks

The Board of Directors regularly considers company and industry risks in making Board decisions. Under executive compensation rules adopted by the SEC, annual proxy statements for the annual meeting of shareholders must disclose any material incentives that can lead to excessive or inappropriate risk taking by employees. Additional disclosure is required regarding the leadership structure of the Board of Directors and the Board's role in the company's risk oversight process, including credit risk, liquidity risk and operational risk.

Directors may take further steps to monitor risk. Specifically:

- Directors may request additional information and presentations from company management about legal risks and risk management.
- The Board may adopt policies to deal with an emergency or company crisis, with the objective of facilitating communications among senior management, legal counsel and other advisers.

Conclusion

Directors who serve on the Board of a public company bring business judgment, industry experience and special expertise that drive the company's strategy and financial results. Good governance practices can complement a company's strategy and results by setting the "tone at the top," communicating with shareholders, reducing business risks and enhancing Board performance.

A Modern Corporate Practice

Business built America. Being your own boss and serving your customers well was the American Dream. You opened your doors and hung your sign. Business was simple. And now it's not. Concrete or virtual? Domestic or international? Public or private? Expansion or contraction? Facebook or Twitter? We operate in a world of stiff competition and even stricter regulation. Companies of all sizes are operating domestically and internationally, facing laws and regulations that span borders and boundaries, languages and cultures. Reach, size and demand have gone global. Andrews Kurth's team of more than 100 corporate lawyers, spread across all eight of our international offices, are helping clients define their companies, stake their claim in the world market and serve their investors without alienating their customers.

The Andrews Kurth Corporate Practice:

- Works closely with Fortune 500 companies and emerging growth companies alike, carefully balancing business objectives with regulatory compliance and corporate governance requirements.
- Helps clients devise and implement long-term development cycle strategies, from mergers and acquisitions, IPOs, stock and asset purchases, tender offers and proxy fights to exit strategies, auctions and spin-offs.
- Was involved in the creation of the first MLPs in the early 1980s and served as issuer's counsel on the first "drop down" MLP in 1983.
- Serves as counsel to more than 200 public companies in corporate and securities law.
- Offers significant experience with the structure, finance and development of energy projects, both traditional and alternative, around the world.

- Participated in third largest IPO in U.S. history, as ranked by *The Deal* magazine's Deals of the Year, February 2011.

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Melinda Brunger is a partner in the Corporate Securities section of Andrews Kurth LLP, with 20 years at the Firm. She has an MBA and JD. Her practice includes public company M&A transactions, public offerings, special committee representations and proxy contests. She has an extensive practice advising clients regarding public disclosures, shareholder proposals, compliance and corporate governance.



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