



Governance Fundamentals

Everyone these days is focused on corporate governance as if it were a new concept. In fact, the obligations of directors and the practices and processes around Boards and management have been around for years, and stem primarily from state corporation code requirements. The primary goal of a sound corporate governance program is to help directors meet their fiduciary responsibilities. In doing so, directors are more likely to obtain the protection of the business judgment rule for their actions. Below are a series of questions designed to raise awareness of some of the fundamental corporate governance practices and processes that are used to help make Boards more effective and efficient. Following the questions are brief descriptions of just some of those practices in use by Corporate Secretaries of many well-run public companies.

- Is your Board satisfied with the support it receives from the company?
- Are you meeting the SEC and stock exchange requirements for effective corporate governance?
- Are your Board and Committees properly staffed and getting what they need to satisfy their fiduciary obligations and to function properly?
- Are meetings well planned, well attended and properly documented?
- Do you have an effective Board orientation and education effort?
- Are the right resources in place to interact with your Board and implement your governance practices?
- Are you confident that you have adequate equity grant practices and governance?
- Are your investors satisfied with your governance practices?

How do you respond to these questions? Today's regulatory environment makes having a sound governance program a corporate imperative. There is data to suggest that companies with sound governance programs perform better. Sarbanes Oxley, the SEC and the stock exchanges have each imposed governance requirements on public companies, not to mention the expectations of investors, director and officer liability insurers, and proxy advisory services. State corporation law also sets forth certain legal requirements for Boards for both private and public corporations that are part of a company's governance. Recent court decisions, such as the Disney case,¹ make clear that certain governance standards should be met in the process. Companies, both public and private, and their Boards need to ensure that their corporate governance practices and processes are in order.

Most corporate governance failures can be traced to ineffective service provided by Board advisors and inadequate controls on governance processes. This is true for large and small corporations alike. In a climate of increased focus on corporate governance, Boards themselves need to ensure that fundamental governance practices and processes are in place at their companies.

The role of Corporate Secretary is an increasingly important and visible one as the person in that role is generally responsible for the company's corporate governance. The lawyers and professionals comprising the Corporate Secretary function effectively combine practical knowledge of the detailed requirements with sound practices and processes to ensure a high standard of governance. The Corporate Secretary is responsible for appropriate recordkeeping of Board and committee materials, developing agendas that capture required Board action, drafting materials and resolutions for Board consideration and drafting artful minutes that demonstrate the Board's diligence in exercising its responsibilities. Without these fundamental practices in place, the Board may have to resort to unanimous written consents because regular meeting agendas have not captured required actions. Meeting minutes may be poorly drafted. In such situations, the Board faces exposure in the event of legal or regulatory proceedings, or audits where Board meeting minutes and Board records will come under very close scrutiny. In the commentary that has followed the Disney decision, it has been noted that the governance processes in place when that case first arose in the mid-1990s would not be tolerated today by the courts in the post-Sarbanes Oxley environment.

The Corporate Secretaries at well-run public companies keep their Boards organized and operating efficiently using a standard set of procedures and practices such as those briefly described in the next sections. These procedures and practices provide a framework for the Board to meet various legal and regulatory requirements. Ultimately the goal is to provide a comfort level for the Board that it is getting what it needs, that appropriate records are being kept, procedures are followed and policies are in place.

1. Develop Annual Agendas. The organization of the Board and its processes are critical to the smooth functioning of the Board. Before the beginning of each year, the Corporate Secretary should develop draft agendas for each of the Board and committee meetings. Those draft agendas should reflect historical agenda items, as appropriate, committee charter requirements, other required matters (*e.g.* officer elections, director nominations, Section 16 designations, approval of the 10-K), benefit plan matters, regular financial reports, regular reports of the general counsel, corporate strategy presentations, as well as any corporate governance or other matters set forth in the corporate governance guidelines. Refer to the company's corporate approvals process for additional matters requiring Board or committee approval. The draft agendas should be reviewed with senior management, including the general counsel, and as appropriate, by the Chairman of the Board and Presiding or Lead Director, if any, and Committee Chairs. Once through that process, the annual agendas can be submitted to the Board and committees for their approvals. Prior to each meeting the agendas are again reviewed by senior management, modified or supplemented as necessary, and once again shared with the Chairman, Lead or Presiding Director and Committee Chairs.

These agendas may be also used as part of the Board/Committee evaluation process as an objective measure of the Board's performance. If at the end of the year the Board attended to

those matters identified at the beginning of the year, it can be said to have substantially met those particular objectives.

2. Develop a Two-Year Meeting Schedule. The Corporate Secretary should, on an ongoing basis, have a schedule of meetings for the Board and each of its committees that goes out at least two years. When deciding on that schedule, consideration is given to the company's particular cycles, earnings release and quarterly and annual SEC filings schedules, the timing of the annual budget review and other recurring matters requiring Board or committee approval. Stagger committee meetings so that directors on more than one committee are able to attend all meetings. Other considerations are the schedules of the directors and their other obligations. When polling directors as to their availability, reaching quorum at each meeting is essential. The Corporate Secretary should develop a proposed schedule and then work with the directors and their support before bringing the schedule to the full Board for approval.

Adequate time should be allocated to the meeting schedules for the Board and Committees to perform their obligations. Regular meetings can last 3-5 hours or more. Audit Committee meetings tend to require more time than some other committee meetings, but some attention should be given to the matters being presented and the appropriate amount of time to allocate to each. Compensation Committees have been called the "new Audit Committees" because of the SEC's new executive compensation disclosure requirements which may require more meeting time than in the past (which also translates into the need for carefully crafted minutes and meeting materials that will serve as support for such disclosure.) At least once each year, the Board should meet for an annual strategy session to be able to fully delve into the company's financials, its short and long-term strategic plans and director education, among other things. This session is often held offsite, and can last for 2 or more days.

3. Development and Distribution of Board Materials. Essential to the proper functioning of the Board is the quality of materials it receives in advance of meetings, and how long the members have to review the materials. Senior management must be disciplined in its development of materials and ensure that the Board is presented with appropriate background for each matter in which action is required. For significant matters, the underlying documentation should address, among other things, the financial implications, risks and uncertainties, and alternative strategies, along with an executive summary. Draft resolutions should be included in the materials. Agendas should reflect which items are included in the distribution. For "housekeeping" or routine matters, they may be presented as "consent" items so long as sufficient background is provided to the Board in advance.

Secure electronic delivery of Board materials is becoming more popular and is an efficient way to deliver materials, but attention must be given to the individual work styles of each director. Regardless of the delivery method, materials should be sent out no later than one week prior to regularly scheduled meetings. Occasionally, transactions or other matters requiring Board action arise quite suddenly or are so fast moving that directors will often have less than a week with the materials. In such cases, advance communication with the directors to let them know the proposed timing so that they can set aside time on their calendars is essential. In such cases, electronic delivery can speed the process considerably.

Board and committee materials must be properly stored and maintained as part of the record of the meeting. Company practices vary as to how long such records are kept. Forever, is not too long.

3. **Minutes Matter.** Minute taking is no longer considered to be a ministerial function. Skilled professionals should be taking Board and committee minutes, which should be complete and contain sufficient detail. Minutes need to be drafted with consideration for the elements of the business judgment rule: that the directors acted on an informed basis, in good faith and not in their personal self interest. The level of detail on a particular topic in the minutes will depend on the nature of that topic. Minutes should reflect who was present at the meeting, and make clear reference to materials provided to the directors both in advance of and during the meeting. They should note if the topic was discussed and, if required, include any resolutions adopted. Minutes should not reflect what each director said, but rather note more generally that questions were raised on particular topics, and that discussions occurred. In the Disney case, the minutes were incomplete and inconsistent, and it was suggested that the drafter did not understand their purpose – and may not have been at the meetings. (While this practice is not uncommon, it is not acceptable.) In that case, had the minutes been adequately drafted, the case might have been dismissed in 2003.

Once drafted and reviewed internally, minutes should promptly be distributed to the directors for their review before memories fade. In some cases, subject matter experts such as tax or benefits lawyers should be part of the review process. Directors can formally approve minutes at the next scheduled meeting. Following the Board's approval of minutes, any notes or drafts should be destroyed.

4. **Director Education.** To keep the Board abreast of current trends in the business, important legal developments, and as a refresher as to their ongoing obligations, time should be set aside on meeting schedules for some director education. Additionally, external educational opportunities should be made available to the directors at the company's expense.

5. **Director Orientation.** As they join the Board, new directors should be educated about the company through presentations by senior management regarding the business of the company, the financials, current strategic efforts, risk management, human resources and executive compensation. Additionally, new directors should learn of the company's corporate governance practices and initiatives.

6. **Board Evaluations.** The Board and its committees should regularly evaluate their own performance. Both objective and subjective criteria may be used. Attending to the agenda items established at the beginning of the year may be used as part the evaluation. The Corporate Secretary can facilitate the evaluation process, which may be oral rather than written, and then summarized for the Board. Sample evaluations² abound, but should be tailored to the particular company and its Board. Occasionally outside consultants may be brought in by the Board to conduct the evaluation and report back the results. In some companies individual director evaluations are being conducted, again often through oral interviews. The nature of the evaluations can vary from company to company, but in all cases should be handled with discretion.

Conclusion

Having a sound corporate governance program in place is a corporate imperative in today's regulatory climate, both from an internal as well as external perspective. The practices above are just some of the fundamental processes that directors should expect from their companies and are in use by Corporate Secretaries at many companies. Directors need to know that they are getting what they need to make their decisions, that minutes are being drafted to reflect their deliberations, and that appropriate records of those meetings are being kept. Externally, regulators expect their requirements to be met. Finally, with a strong governance program in place the company's reputation with investors, credit rating agencies, D&O insurers and proxy advisory services will be enhanced. Companies with sound governance programs may perform better. It stands to reason.

¹ *In re Disney Co. Derivative Litigation No 411, 2005 (June 8, 2006)*

² The Society of Corporate Secretaries and Governance Professionals is an excellent corporate governance resource and has copies of evaluations used by its members. www.governanceprofessionals.org.

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