

The general counsel's perspective

Today's general counsel, trusted adviser to the corporation, faces the challenges of a litigious society, media scrutiny, and the complexity of business risk. Considerable attention has focused on the importance of the general counsel in ensuring good corporate governance, and the consequences of ineffective governance. This issue of *InSights* has been developed to explore the perspective of the general counsel, with the goal of helping audit committee chairs gain a deeper understanding of:

- The evolving role of the general counsel
- Key challenges the general counsel faces and how those challenges relate to the audit committee
- The elements of a high-value relationship between the general counsel and the board, including what audit committee chairs should be doing to get the most out of this relationship
- Key characteristics that distinguish an outstanding general counsel

Tapestry Networks asked members of several networks of audit committee chairs to identify general counsel who exemplify leading practice. They nominated general counsel from more than a dozen large- and mid-cap North American public companies. Fred Krebs, President of the Association of Corporate Counsel (ACC), also participated in this research. The general counsel who participated were:

- Art Bensler, Executive Vice President, General Counsel, and Corporate Secretary, Teekay Corporation
- Tom Bogart, Executive Vice President and General Counsel, Sun Life Financial
- Steve Cutler, Executive Vice President and General Counsel, JPMorgan Chase
- John Del Col, General Counsel, Secretary of Endurance Specialty Holdings, and Executive Vice President of Acquisitions, Endurance Specialty Insurance
- Ivan Fong, Chief Legal Officer and Secretary, Cardinal Health
- Bill Jordan, Vice President and General Counsel, DSW
- Theresa Lee, Senior Vice President, Chief Legal Officer, and Corporate Secretary, Eastman Chemical
- Don Liu, Senior Vice President, General Counsel, and Corporate Secretary, Xerox
- Larry Miller, Senior Vice President, General Counsel, and Secretary, Teleflex
- Anne Mule, Chief Governance Officer, Assistant General Counsel, and Corporate Secretary, Sunoco
- Gil Tily, Chief Legal Officer, Executive Vice President and Secretary, Amkor Technology
- Peter Urbanowicz, Executive Vice President, General Counsel, and Secretary, Tenet Healthcare
- David Vetter, Senior Vice President, General Counsel, and Secretary, Tech Data

This document uses a modified version of the Chatham House Rule whereby names of contributors to the research and their company or organization affiliations are a matter of public record, but comments made in the conduct of the research are not attributed to individuals. Fred Krebs has given permission for his comments to be attributed.

Executive summary

This document will review the role of the general counsel, explore the extent of change in the role, and suggest ways in which the audit committee can get the most out of its relationship with the general counsel. Several themes are developed in the following pages:

- **General counsel say the spotlight shines brighter on their role and expectations are higher** *(Page 2)*

The general counsel (GC) is at the crux of good corporate governance and business management. The GCs participating in this research reported that the essence of their role as the guardian of the corporation has not changed, but observed that the environment in which the GC operates changed significantly after the corporate scandals earlier this decade: expectations are now much greater.

- **Challenges general counsel face today center on maintaining independence** *(Page 5)*

Resolving the tension between being a member of management and serving as the guardian of the corporation is the essence of the GC's role, yet an ongoing challenge nonetheless. Maintaining independence of thought and the ability to say no is often the hardest part of the job for the GC. It is also critical to being effective.

- **GCs see the most value in a high level of engagement and communication with the audit committee** *(Page 5)*

In order for the GC to be effective as a trusted advisor to the board and the audit committee, processes must be in place to ensure there are opportunities for independent engagement and a free flow of communication. GCs recommend the development of a relationship outside of formal meetings to maximize their effectiveness.

- **GCs often provide significant value: characteristics of outstanding general counsel** *(Page 7)*

Outstanding GCs focus on creating long-term value by making themselves integral to the business of governing and managing the corporation. The best GCs serve as models of ethical behavior, build trust required for an open dialogue with the board and management, translate legal technicalities into useful explanations, and look beyond legal restrictions to provide solutions to current business problems.

GCs say the spotlight shines brighter on their role and expectations are higher

Many wondered if the corporate scandals and subsequent regulatory changes earlier this decade would provoke a change in the role of general counsel. Participants in this research believe that the GC continues to be the guardian of the corporation and its reputation, but that today a brighter spotlight shines on the role, particularly as it relates to good board governance. Additionally, participants pointed out that the environment in which the GC operates has changed significantly; the consequences of an ineffective GC being much greater.

The role of the general counsel

Participants stress that GCs serve the corporation and its shareholders, not a particular individual or client. This presents a unique challenge for the general counsel, whose job it is to remain independent, acting on his

or her interpretation of the law and what's best for the corporation. One general counsel advises new GCs, *"You must maintain your professional judgment and independence because compliance is for the company, not one business executive. If you ever feel you're in a position where you're conflicted, then you need to walk away."*

As part of the senior leadership team, the GC has responsibility for the entire legal organization internally, which consists of the business unit GCs and specialty or functional counsel, such as for mergers and acquisitions. Most often, the GC also oversees the corporate ethics and compliance function. Additional functional areas that may report to the GC include risk management, external affairs (including public and governmental relations), tax compliance and planning, and insurance. In the company of one participant in this research, the internal audit function also reports to the GC. This participant stated, *"In our case, this seems to work well ... the internal audit function has a lot more independence operating under the GC simply because most of the stuff that an internal audit group does is related in some way to finance. The lawyers tend to not have a lot of direct impact on the books and records of the company, so I think there is a perception of more independence."*

The GC has an important role in ensuring effective corporate governance and the board's fulfillment of its fiduciary responsibilities. The Sarbanes Oxley Act of 2002 (SOX) and the New York Stock Exchange listing standards require compliance with charters and corporate governance principles (and proper evidence of that compliance) – responsibilities that fall to the GC.

In addition to attending all board meetings and providing a legal report to the board at least annually, the GC attends most board committee meetings. Although GCs in this research felt it was best practice for board committees to hold regular executive sessions with the GC, this practice is not universally followed.

Some voiced a missed opportunity in this area: *"The board is not doing itself a service having executive sessions [only] with the CEO at the end of the board meeting ... No senior manager [who reports to the CEO] is ever going to raise issues directly with the board unless those discussions are in private session."* When there is significant litigation risk, GCs believe that communications to the audit committee and/or the board should be more frequent to keep directors and committee members apprised of ongoing developments.

In addition to serving as GC, most of the participants in this research also serve as corporate secretary. The corporate secretary's duties include working with the chairman to set the board agenda, playing an editorial or gatekeeper role over materials that flow to the board, ensuring board-management communication between meetings, and recording board minutes. One GC and corporate secretary said, *"The general counsel has the ultimate authority over the materials presented to the board and audit committee. Those pieces of information are truly the bedrock upon which the board's ability to act is developed. As a consequence, the GC's job is first and foremost to make sure the information provided is complete and accurate and faithfully represents the financial information of the company."*

Changes in the role

GCs have felt the most change in the area of corporate governance and the attention their actions receive. One GC stated, *“The role of the general counsel in serving as an adviser to the board has evolved over the past few years into a much more critical function.”* Another said, *“In my mind, this has historically been a part of what the general counsel should do, but it’s become much broader and much more difficult given the external trend, which is to hold the general counsel more responsible.”* Fred Krebs of the ACC concurred: *“I don’t think the fundamental responsibilities and opportunities have changed, but what has changed is the increased scrutiny and the willingness of prosecution to go after bad results.”*

A plurality (36.3%) of GCs surveyed in the *2006 Association of Corporate Counsel Chief Legal Officer Survey* identified more engaged board members as the “single most positive outcome of Sarbanes-Oxley and/or other governance reforms.”¹ One consequence of this increased engagement has been a significant expansion in the corporate secretary’s responsibilities, which, since the same person often acts as GC and corporate secretary, has had a knock-on effect on the GC. One GC stated, *“I wouldn’t say the role of the GC has changed necessarily, but that role of combined secretary and GC is different. My role with the board in the past three to four years has definitely changed.”* Another went on to say, *“My role has changed a lot because I am now more of the management interface with all of the independent directors ... There is a lot more process now, and it takes a lot more time. Instead of just interfacing with the CEO, who used to run everything years ago, now you have the independent directors doing a lot more, and in order for them to do that, they need support. That’s my job.”*

Some feel the role of the corporate secretary is now so demanding that it is difficult to juggle those responsibilities with the *“huge amount of legal work”* required of the GC. That said, participants do not expect a trend toward separating the GC and corporate secretary roles; they felt that the decision to combine or separate those roles is situational, based primarily on personal preference and historical practice. In addition, participants agreed that the role of corporate secretary is necessarily a legal one: *“It would be impossible to [be the corporate secretary] if you weren’t a lawyer ... Much of what the board focuses on has legal ramifications.”* Fred Krebs added that there is no one-size-fits-all answer: *“It is very culture driven and people driven, depending on the talents and skills of individuals that are there.”*

Other GCs reported an increase in responsibilities in conjunction with their role as a member of the senior management team. Several pointed to the increased expectation that the GC should act as a business partner who will weigh in on strategic business decisions: *“There is a greater expectation that GCs are part of the business leadership team, so this is something I’ve adopted. It is the view that the GC and all corporate counsel really need to be business partners, need to understand the business, markets, competitive environment, product services, and technology in order to be able to give broader, more strategic advice. It means that the GC needs to have business acumen and strategic business skills that weren’t needed in prior years.”* Despite these challenges, many attorneys enjoy “going inside,” making the career shift from outside counsel to internal corporate counsel. As one participant observed: *“[The ability to participate in senior management decisions] is one of the most exciting parts of the job; you’re part of the action.”*

¹ Association of Corporate Counsel, *2006 Chief Legal Officer Survey* (Washington, DC: , 2007), 5. Available at <http://www.acc.com/resource/getfile.php?id=7882>.

Challenges general counsel face today center on maintaining independence

GCs find it challenging to be part of the senior management team, reporting to the CEO, while still maintaining their independence. As one participant put it, *“The hardest part of this job for me is walking the line between a member of the management team as an advocate and colleague, and still being independent when I need to be independent. Management might see it differently than I do, and that’s the toughest part about this job.”* Another stated, *“GCs have a very difficult responsibility today, reporting to the CEO [while also] being the attorney of record to the corporation under the canon of ethics.”*

Participants said the GC must have the strength of character to say no even when doing so is unpopular with fellow executives. In recent years, many internal auditors have established a direct reporting relationship with the audit committee in order to ensure independence from senior management. However, few GCs described a similar reporting relationship with a board committee, and participants acknowledged that their direct manager – typically the CEO – had significant influence over their career and compensation. This means that GCs must depend on their internal ethical compass to guide their actions without the safety net of an independent reporting relationship. As one participant pointed out, *“[My boss] could fire me tomorrow ... That said, a long time ago I figured out that no matter what I did, I wasn’t going to compromise my principles, and I don’t make decisions based on whether or not I’m going to lose my job.”*

While it is the responsibility of the GC to say no at the appropriate time, GCs also said they need to take a constructive, not obstructionist, position on difficult issues. The ongoing success of the GC depends on people in the organization continuing to confide in this person, thereby providing opportunities for the GC to offer legal and compliance advice: *“You need to be able to say no in a way that people will return to you in the future for advice.”*

Additional challenges GCs face include:

- **Being tyrannized by the everyday.** *“It’s easy to get caught up in the crisis of the moment, but it’s important to be forward looking, and that’s where you add value as the GC.”*
- **Explaining the law in a simple, practical way.** One GC said, *“The hardest part about my job is trying to tell people why things are really issues and explaining it in a simple way.”* Another stated, *“It would be easy to make a legal pronouncement and then turn and run for cover.”*
- **Staying on top of the increasing complexity of business.** *“There is an increasing level of sophistication that’s required.”*

GCs see the most value in a high level of engagement and communication with the audit committee

GCs appreciate that audit committees have been in the spotlight in recent years. With the legal implications of accounting judgments weighing heavily on audit committees, GCs recognize their responsibilities are critical to the functioning of the audit committee and require a great deal of preparation. For their part, audit committees recognize the value that GCs can offer, indeed some rely heavily on their GC. As one audit committee chair told us recently, *“The general counsel is critical to audit committees. They see issues that may not be on the minds of finance people.”*

InSights

FOR AUDIT COMMITTEE MEMBERS

Although GCs generally participate in audit committee meetings in open session, many GCs also meet with the audit committee in executive session each quarter. Participants value this executive session because it permits them to raise issues and ask questions without other executives present. One GC reflected on how he approaches that discussion: *“I don’t go in [to these meetings] with a presentation per se; I go in with a mental list of things that are top of mind for the past quarter and looking forward to the next. It’s an opportunity for candid conversation.”*

Those who do not meet independently with their audit committee regret what they see as a missed opportunity: *“My audit committee is not demanding that I attend every audit committee meeting ... In a more informal dialogue, I could advise the audit committee where it should be probing and asking questions, but this rarely happens as the committee is so caught up with [its] workload.”*

Beyond the need for private sessions with the audit committee, GCs agreed that regular interactions outside of formal meetings help to build trust and ensure frequent, open communication: *“One of the most important parts of the relationship is that I have an open line of communication to the audit committee, and there is strong trust and confidence that I’m thinking about the company and its shareholders.”* Another GC stated, *“I have a regular dialogue outside of actual audit committee meetings with the [audit committee] chairman. We discuss the [committee] agenda and particular issues. I would call him and tell him about any big thing as it happens.”* Other GCs highlighted the importance of touching base with the audit committee chair before meetings, via e-mail or pre-conference calls. Indeed, one GC speaks with his audit committee chair as frequently as once a week.

Some GCs believe that, post-SOX, there is too much emphasis on financial expertise on audit committees, to the detriment of the big picture. One GC reflected, *“The law hasn’t done enough to set the precedent on the type of people on the audit committee. If you look at the audit committee’s responsibilities in the law, they are as much qualitative as quantitative, yet the focus now is financial.”* Another stated, *“Our challenge is to step back and remember why we’re here.”*

As the individual charged with ensuring good corporate governance, the GC could play a valuable role in ensuring the appropriate composition of the audit committee. One participant suggested, *“The audit committee membership or process might need to be driven by the governance committee ... the audit committee isn’t going to change themselves.”* This same participant noted that audit committee members might benefit from more specialized education in industry-specific risks (as opposed to a more general director education) as a way of enhancing the committee’s effectiveness. See the appendix on page 9 for a list of recommended questions the audit committee and GC should be asking about working together.



How to strengthen the relationship between the GC and the audit committee

- **Build trust.** *“This is the single [most important] driver of an effective working relationship between the board and the general counsel.”* GCs say they can build this trust over time by consistently providing impartial opinions on board matters. The board and audit committee must trust that their GC will speak up if he or she has a differing opinion.
- **Be clear on expectations.** *“To get the most out of [me], [my audit committee chair] is very clear about what he needs from me, and he lets me know when he doesn’t like something.”*
- **Hold private sessions regularly.** *“When you’re at the board table, sometimes it’s hard to be candid if your boss [the CEO] is [also] at the table.”*
- **Ensure a dialogue exists outside of formal meetings.** The ability to pick up the phone and ask a question or have an open conversation greatly increases the effectiveness of this relationship.
- **Use the GC as an early-warning system.** *“Audit committees are usually looking in the rearview [mirror].”* The GC can help the audit committee be more proactive, particularly around risks.
- **Ensure the GC has sufficient technical knowledge.** *“I’ve seen GCs falter because they haven’t educated themselves on technical things like accounting.”*

GCs often provide significant value: characteristics of outstanding general counsel

Ben Heineman, former longtime general counsel at General Electric who built a best-in-class legal organization, describes the role of GC in this way: “The role of general counsel, as a member of senior management, should on most matters facing the company, assess them for legal, ethical, reputational, and, when knowledgeable, commercial risk. And then to take it to another level, this then involves being both a business partner to the business leadership, but most importantly being a guardian of the company ... But clearly, to be effective, you have to be a partner to the CEO as well as a guardian of the corporation. Simultaneously resolving that tension is what the job, in essence, is all about.”²

GCs in this research concurred, adding that while some view legal and compliance as a cost center, an outstanding GC will look at it as a long-term value generator. One GC went on to say, *“Part of this is rendering advice that [may elicit] a short-term negative reaction, but keeps in mind the long-term bigger picture.”* Another stated, *“Everyone thinks the GC role is about risk mitigation, but I think it is more about opportunity optimization ... you work with people in the business regarding entering contracts. How much time do you spend identifying risks versus opportunities?”*

² Ben W. Heineman, Jr., “How to Say No to Your CEO,” *ACC Docket*, October 2007. Available to ACC members at <http://www.acc.com/resource/v8697>.



According to research participants, outstanding general counsel:

- Set the tone at the top by modeling ethical behavior.
- Stay ahead of the curve to steer the corporation away from trouble before it arises.
- Build trust with board members and senior management to ensure a candid, open dialogue.
- Are aggressive to be sure they're included in important decisions.
- Volunteer answers rather than waiting to be asked the questions.
- Provide real, practical, sound advice, and deliver it in plain English, not legalese.
- Understand how the company makes money.
- Know when to say no and don't shrink from saying it.
- Are able to identify and bring in the best outside legal advice.

Conclusion

The general counsel has a unique role as the guardian of the corporation. With today's increased emphasis on effective corporate governance, expectations of the GC have never been higher, yet some organizations have not addressed the structural, procedural, and relationship issues whose resolution would make it possible for the GC to perform optimally. With most GCs still relying on the CEO for pay and promotion, board directors might well ask if the current reporting structure offers adequate protection to ensure independence.

As one GC said, *"You want a [reporting] process in place before you need it, so you have it in place when you do need it."* Similarly, the audit committee should see what more could be done to ensure an open and ongoing dialogue with the GC. If process constraints, or the presence of the CEO during key conversations, prevent the GC from voicing concerns frankly and forthrightly, the company will suffer. With the proper support, the GC can serve as an essential business adviser whose role transcends management and the board, one who looks ahead and helps steer the corporation clear of potential threats and pitfalls.

Appendix: Questions the audit committee and GC should ask about working together

- ? Should the committee meet in executive session with the GC? How often?
- ? Are the expectations and processes for working with the GC explicit and understood by the audit committee and the GC?
- ? How can the GC help the audit committee fulfill its compliance and other legal requirements while preserving time to discuss other important issues?
- ? What are the company's most important risks? What is the GC's perspective on those risks, as both a legal and a business adviser?
- ? When quantifying the impact of litigation risks, does the audit committee take into consideration the legal fees associated with ongoing litigation? How can the GC help the audit committee understand the full impact of significant litigation?
- ? Does the audit committee look at the litigation portfolio – that is, the negative litigation against the corporation as well as the positive litigation the corporation is pursuing? Does the GC provide useful estimates of legal fees likely to be incurred?
- ? How can the GC guide the audit committee in its quest for relevant education on key issues?
- ? What people and processes does the GC believe would enhance the effectiveness of the audit committee?
- ? Based on the GC's insight into other board committees, what advice does the GC have regarding how the audit committee should integrate and coordinate its work with those committees?
- ? What is the nature of the relationships among the CEO, senior management, and the GC? Are there conflicts of which the audit committee should be aware?

About this document

InSights is produced by Tapestry Networks to provide assessments of key issues of interest to audit committees. Initially, *InSights* will be distributed to members of audit committee networks sponsored by Ernst & Young and orchestrated by Tapestry Networks, who, in turn, will share it with colleagues on audit committees and boards, and their advisers. It will be distributed by Ernst & Young to its partners. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

The views expressed in this document represent those of the individuals who participated in the research. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young, or Tapestry Networks. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization, including the U.S. member firm of Ernst & Young LLP.

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