

Lead Director Network ViewPoints

November 6, 2013



The general counsel's relationship with the lead director and the board

On October 2–3, 2013, Lead Director Network (LDN) members met in Washington, DC, with general counsel (GCs) from many of the public companies represented in the network to discuss how GCs can work with their lead directors and boards most effectively. For further information about the LDN, see "About this document," on page 8. For a list of participants, see the appendix, on page 9.

Over the course of the previous 15 meetings of the network, LDN members have discussed issues that demand effective collaboration between the lead director,¹ board, and GC, but this was the first LDN meeting to address the topic directly. Three key themes that emerged during the meeting are described in more detail in this issue of *ViewPoints*.²

Executive summary

- **The GC's role** (*page 2*)

The quality of a company's general counsel may influence a director's decision to join the company's board, and directors are keen to provide input when a company selects a new general counsel. Lead directors and GCs described great GCs as trusted, clear, composed, courageous, business savvy, and wise. In addition to having the core responsibilities of chief legal officers, some GCs also serve as corporate secretary, chief compliance officer, or as a business function leader. Holding these additional titles presents both benefits and drawbacks; for example, serving as corporate secretary gives the GC more time with directors, but can take time away from other responsibilities.

- **GC and lead director relationship dynamics** (*page 4*)

The relationships between the GC, lead director, and CEO are important to a company's performance and a board's effectiveness. Many lead directors interact with their GCs more frequently than with any other member of management, and they look for frequent, open communication. General counsel establish strong relationships with directors by meeting with them outside the formal board meeting cycle. At these additional meetings, everything from board processes to company strategy may be discussed.

- **Situations that test the GC relationship** (*page 5*)

Lead directors and general counsel identified a number of situations that test their relationship and that require strength and unity of purpose in order to achieve an effective corporate response. Three situational proving grounds stood out for both groups: cybersecurity, shareholder activity, and situations involving disputes and regulatory compliance. Lead directors and general counsel were particularly interested in the

¹ Lead Director Network documents use the term "lead director" to refer interchangeably to the titles *lead director*, *presiding director*, and *non-executive chairman* unless otherwise stated.

² ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

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decision to appoint a special committee or retain independent counsel for the board, noting that these actions should not be taken lightly, as they can increase friction in the company and the boardroom.

The GC's role

In recent years, matters requiring the general counsel's legal and business judgment have increased in both number and significance. Globalization, rapid technological advances, increasing regulatory burdens, political and reputational risks, and many other factors have changed the nature of business and challenged senior leaders, including the GC. At the meeting, lead directors and GCs discussed the strengths of great GCs and the various roles GCs may play within their companies.

Strengths of great GCs

Directors pay close attention to the quality of a company's GC: *"I want to meet with the GC and the CFO of a company before I join its board because of how critical both roles are,"* one lead director said. When the company is looking for a new GC, lead directors want to be involved in the process. *"With the GC, we want to have input, to ask questions, and to establish a comfort level,"* one said. *"Directors feel that the general counsel is the first line of defense for the board."*

Lead directors and GCs identified six traits that are particularly important in a GC, given the GC's wide-ranging responsibilities:

- **Trustworthiness.** *"The most basic requirement for a general counsel is to be trusted ... The board knows the GC will report on any matters of significance at the appropriate time,"* one GC said.
- **Clarity.** The GC *"must have the skill to present legal information to non-lawyers effectively,"* one lead director said. That clarity makes GCs better counselors and partners to business heads and more effective as *"the bridge between the management team and board,"* another said.
- **Composure.** Board directors look for a GC *"whose hair can't catch fire; someone who is unflappable."*
- **Courage.** Lead directors want confidence that the GC will act courageously when necessary. One lead director recalled a situation in which a GC had informed the board about a CEO's impropriety: *"The CEO was gone by the end of the board meeting. It was the right thing to do, but it took real courage to bring that to us."*
- **Business acumen.** Lead directors frequently said that the best GCs stood out for coupling business expertise with their legal knowledge. *"The issues with which the GC is dealing are more than just legal – they are business questions that are integral to our business,"* one lead director said. *"The GC is critically important in every business meeting,"* another lead director said.
- **Wisdom.** *"The GC needs to understand [corporate] governance, but cannot let that outweigh the company's other interests,"* one lead director said. *"The best GCs understand how all of these things fit together to determine the best response."*

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Where should the GC be placed in the organizational hierarchy?

Directors should be attentive to the GC's rank within the organization, as that may signal the value the company places on the individual or the legal function. *"Where the GC sits in the organization matters a great deal in terms of effectiveness,"* one general counsel said. *"It's difficult to be the guardian and conscience of the company if you are not seen as a senior leader."*

Regardless of their location in the hierarchy, GCs are often expected to provide both legal and business advice. *"My CEO told me, 'I want you to give me legal advice, I want you to give me business advice, and I want you to be crystal clear about which type of advice you are giving me,'"* one GC said. One company has an informal policy for the GC: *"Unless I say otherwise, I'm giving business advice as any other member of senior management. If I'm providing legal advice, I'll make it clear that I'm now putting on my legal hat."*

Additional responsibilities

GCs often fill a number of official roles. In addition to core responsibilities as the chief legal officer and the manager of in-house and outside counsel, GCs may hold other titled positions as well.

- **Corporate secretary.** There were differing views in the meeting about whether GCs should also be the corporate secretary. Several GCs said that it was important for the GC to serve as corporate secretary: *"Without that role, there's a disconnect between the general counsel and the board,"* one GC said. GCs agreed that if another individual was corporate secretary, even if they reported to the GC, that person would naturally spend more time with board directors than the GC.

However, other GCs noted the benefits of separating the two roles. At the meeting, a GC who is not corporate secretary said that the corporate secretary role *"is very substantive and demanding if done properly. When someone else handles those responsibilities, it frees me up to be a better member of management."*

- **Chief compliance officer.** Many companies are currently considering where to place compliance responsibilities within senior leadership. In particular, companies that have a chief compliance officer (CCO) must decide whether to make the GC responsible for the function. There are three common organizational approaches: the CCO is independent of the GC and reports directly to the CEO and board, the GC is also the CCO, or the CCO reports to the GC and the CFO.³ Some GCs consider compliance a core responsibility that they would not want to delegate; others have been required (by regulators, for example) to separate the roles, or see benefits themselves in separating them.
- **Business function leader.** Some GCs are also in charge of business functions; for example, they may be head of corporate strategy, risk management, or human resources. Such roles may better position the GC as a true peer within senior management, but GCs in a business role must be

³ See Ben W. Heineman, Jr., *"Don't Divorce the GC and Compliance Officer," Corporate Counsel*, January 2011, 48-49.

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certain that other officers recognize when the GC is providing legal advice rather than their business views.

GC and lead director relationship dynamics

Overall company effectiveness depends a great deal on the relationships between the GC, lead director, and CEO. Lead directors and GCs are therefore naturally interested in improving the quality of each leg in this triangle. Members focused on the lead director's relationship with the CEO at a previous meeting.⁴ At the October meeting, lead directors and GCs focused on the other two sides of the triangle.

The lead director–GC relationship

Lead directors and GCs often cite frequent interaction as the key to a healthy relationship between them. *"I connect with my GC more than any other member of management,"* one lead director said. Another added, *"I don't think a week passes where I'm not in touch with one or more of the general counsel [at my companies]."* The GC should be comfortable working with directors on business matters in between meetings: *"The GC has responsibility to alert the lead director or board when something of significance occurs,"* one lead director said. *"We never want to be caught off guard."*

Some GCs deliberately schedule informal check-ins with the lead director and other members of the board. *"I make a point of seeing every director at least one time outside of formal board business,"* one GC said. One lead director suggested that the GC should schedule meetings with *"some key board members, as well as any who are particularly interested in the GC or the legal function."* Lead directors and GCs who have experience with these sorts of meetings reported that they often discuss the company's strategy and risk oversight, and (where the GC is also the corporate secretary) board processes, including suggested improvements drawn from experience with other boards.

The CEO-GC relationship

Both directors and GCs are keen to see a strong relationship between the CEO and the GC. *"The board and lead director should pay attention to the relationship between the GC and CEO,"* one GC said. *"Confirm it is open and transparent."* Another GC said, *"It will be obvious when the relationship isn't strong. The absence of camaraderie and shared purpose will be visible."*

Directors should be attentive to the CEO's expectations of a GC. One lead director recalled an instance in which the board helped the CEO understand the difference between a lackluster GC and a good one: *"[The original GC] always referred questions to outside counsel. The board initially expressed concern about this and, five months later, the CEO agreed to find a new general counsel. The CEO said that the prior GC came to the CEO with problems and no solutions, just a bill from the outside law firm. We now have a great GC, and the CEO understands what it means to have a first-rate GC."*

⁴ Lead Director Network, ["The Relationship between the Lead Director and CEO,"](#) *ViewPoints*, March 24, 2011.

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Situations that test the GC relationship

Some lead directors and GCs noted that the strength of the lead director's relationship with the GC is revealed in times of stress. Lead directors and GCs identified three areas of frequent stress, in which a strong relationship can result in a more effective corporate response: cybersecurity, shareholder activity, and situations involving disputes and regulatory compliance.

Cybersecurity

Cybersecurity risks are a common concern for directors and GCs. Participants met in a private session with Joseph Demarest, Jr., the assistant director of the Federal Bureau of Investigation's Cyber Division. After that conversation, lead directors and GCs reflected on their own evaluation of cybersecurity risks. All agreed that board conversations about cyberrisks have increased in frequency and intensity over the past few years. *"The question isn't if we'll be attacked, but when,"* one lead director said.

GCs and directors are concerned with many aspects of cybersecurity, but two risks garnered particular attention at the October meeting:

- **Employee risk.** With the Edward Snowden story fresh in their minds, lead directors and GCs recognized that sometimes companies hire bad actors. GCs were worried about employees that have just given notice of their departure. *"Some want to do you harm, others want to take stuff – source code, pricing, other proprietary information – that they can profit from later,"* one GC said. Another GC was considering changing policy to prohibit any company computer equipment from having USB ports accessible to flash memory drives.
- **Vendor risk.** GCs and directors are concerned with how the company's service providers – bankers, accountants, and attorneys – protected confidential client information. *"You can't rely on the contract; you have to audit their system, meet with their people, and tell them what to do better,"* one GC said. One lead director was left unsatisfied even by that degree of vigilance: *"You can audit their systems, but there is still human risk."*

Shareholder activity

Lead directors have said that, in recent years, substantially more board time is devoted to shareholder activity, including say-on-pay votes, shareholder proposals, proxy fights, and requests for direct board-shareholder engagement. GCs take an active role in guiding the board through these sometimes hazardous waters. *"GCs need to be experts in corporate governance, but more so, they need to understand the company's full context to help us make the right call – not overreacting and agreeing with a popular governance change or unnecessarily discarding a good idea that seems unusual,"* one lead director said.

Some GCs expressed concern that shareholder activism has a tendency to impinge too far on the role of the board. *"I'm very concerned with activists' push to impose one-size-fits-all solutions,"* one GC said. *"One-size-fits-all disempowers the people in charge of organizations. It's a terrible thing for business, and it's a terrible thing for America."*

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In part a reaction to this rise in activism, direct engagement between shareholders and directors has become more common in recent years. *“Shareholders expect to be able to meet directors,”* one lead director said. A GC added, *“If a true long-term shareholder requests to meet a director, how can you say no? I don’t think you can.”*

“I once met with a shareholder who was blown away that we as board members knew the company’s strategy so well,” one lead director said. *“On one level, it was quite insulting. But it made me realize how unfairly directors have been portrayed.”*

Some lead directors have previously noted the advantages and costs of board-shareholder engagement.⁵ The group of GCs had similarly diverse views. While some saw the upside, others focused on ways to minimize the burden and risk of direct meetings between board members and shareholders. *“Having a great investor relations organization minimizes the likelihood of shareholder requests,”* one GC said.

GCs said that they do not need to be in the room for direct meetings between shareholders and board directors. *“Sending a GC to a meeting would look defensive,”* one GC said. *“I would not do it.”* While some have suggested that the GC should prepare directors for investor engagements – for example, counseling directors on compliance with Regulation Fair Disclosure (FD) – several GCs disagreed: *“A good person from investor relations can prepare directors just fine.”*

Disputes and compliance

Disputes and compliance can take up a significant part of the GC’s time, but GCs take it as fundamental to their commission to keep this cost of doing business from overwhelming the board or obscuring important strategy considerations. Neither the lead director nor the GC wants the board to get a report on each active or potential dispute. *“I can’t talk to the board about even 1% of the cases we have,”* one GC said. *“The most basic issue in the GC’s relationship with the board is trust that I’ll bring the board the things that are significant for the company.”* In addition to wanting to be informed of the most significant matters, one lead director said that he wants GCs to *“explain the company’s approach to litigation: what is our philosophy [regarding] settling? I want to know how we think about these things.”*

Regarding compliance with an increasingly complex regulatory regime, one GC said, *“There is an incredible and increasing regulatory burden that has required centralizing compliance, creating ongoing relations with regulators, and changing the relationship between management and the board.”* Lead directors and GCs expect that compliance burdens will continue to grow, requiring ever more effective collaboration. Some companies are using their GCs to get out in front of potentially costly political and regulatory changes, even to the extent of turning the approach they adopt with regulators to competitive advantage. *“By doing good work and communicating clearly with [the relevant regulator], we’ve created a strong relationship,”* one lead director said. *“It seems like they have been more lenient with us because of our relationship.”*

⁵ For more, see Lead Director Network, [“A Dialogue with Institutional Investors,”](#) *ViewPoints*, August 9, 2012, 6–9.

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Special committees and special counsel

Does a dispute require establishment of a special committees or engagement of special counsel? Both directors and GCs said that special committees and independent counsel have the potential to create friction within the company. That friction is sometimes necessary or desirable, but some meeting participants recalled situations in which opting for a special committee and independent counsel was the wrong decision. *“Boards often have a knee-jerk reaction for outside counsel ... [but] they often have the counsel they need in the GC,”* one GC said.

The directors, GCs, and King & Spalding explored these potential issues in a case study involving the board’s consideration of a merger proposal while learning of a possibly serious foreign payments issue at an important subsidiary.

➤ Special committees

Special transaction committees are regularly formed to provide structural support for arm’s-length negotiations in “going private” transactions and mergers involving a controlling or dominant shareholder. Merger transactions where the CEO could realize a substantial cash payout and receive future employment and/or investment opportunities raise difficult questions regarding the advisability of a special committee. As long as the board remains actively involved in supervising the negotiations and ensuring that any transaction is in the best interests of the shareholders, a special committee is typically not necessary, and the board is free to exercise its business judgment to delegate to the CEO the responsibility for running the process of negotiating with a potential acquirer and evaluating alternatives. However, depending on the size of the board and the time availability of directors with the right skill sets, many boards will form special transaction committees to provide focused oversight as a means of assuring that the merger process runs smoothly and conflict-free. King & Spalding partner Mike Egan observed that: “Many factors inform the decision whether to form a special transaction committee, including the identity of the acquirer, how discussions first arose, and the history of the board’s consideration of other strategic alternatives.”

Internal investigations of potential corporate wrongdoing raise a different set of sensitive issues. It is often entirely appropriate for management (the general counsel’s office or internal audit) to respond to hotline calls and otherwise conduct the necessary inquiries to detect and remedy compliance issues. Outside counsel may be needed to assist management in larger, potentially more serious matters requiring a greater depth of resources. However, where there are credible indications of possible involvement of senior executives in wrongdoing, a committee of the board (often the audit committee or a special committee) should take charge of the investigation to assure independence from members of management potentially implicated in the investigation. Outside auditors and government regulators will expect active involvement by independent members of the board in such circumstances before accepting the findings of the internal review as independent and credible.

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➤ Independent counsel

Whether a special committee should engage the company's regular outside counsel or independent counsel for advice is a nuanced question raising several considerations. The committee must balance and weigh the speed and efficiency with which regular company counsel can operate due to their familiarity with the organization, its people, and processes against the need for complete independence from management and the issues under review. Many practitioners and observers have recognized that the knee-jerk response in the aftermath of Enron and Sarbanes-Oxley to engage completely independent counsel was often not necessary, and sometimes resulted in costly investigations disproportionate to the matters under review.

Where complete independence from management is a critical consideration (whether in the merger context, such as with an MBO, or in internal investigations into allegations of wrongdoing by senior management), engaging independent counsel with no material prior relationship with the company or management can be necessary. King & Spalding partner Chris Wray observed, however, that "government regulators and outside auditors have shown a willingness to accept that regular outside counsel is not automatically beholden to management, and that with appropriate reporting to independent directors, can handle most engagements. However, in circumstances where senior executives are likely to be directly implicated in the matter under review, the results of the investigation can often be most effectively leveraged with regulators, auditors, shareholders, and the media through use of counsel with no prior material ties with the company."

Conclusion

The relationship between the general counsel and the lead director thrives in an environment of mutual support, which requires strong ties of familiarity and trust. When the lead director knows and trusts the GC, the lead director has confidence that the GC can pilot management in the proper channels, while also serving the board and the interests of the company for the benefit of shareholders. A great GC respects and reinforces the lead director's special position as facilitator and independent leader of the board, and is in turn supported by the lead director, who appreciates the full complement of roles, responsibilities, and challenges the GC must negotiate, both day-to-day and in times of crisis.

About this document

The Lead Director Network (LDN) is sponsored by King & Spalding and convened by Tapestry Networks. Drawn from America's leading corporations, the LDN is a group of lead independent directors, presiding directors, and non-executive chairmen who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute advice for any purpose (legal, financial, business, or otherwise) of network members, their companies, King & Spalding, or Tapestry Networks.

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Appendix: Network participants

The following network members participated in the meeting:

- Dave Dorman, Non-Executive Chairman, CVS Caremark; Lead Director, Motorola Solutions
- Don Felsing, Lead Director, Northrop Grumman Corporation
- Ann Fritz Hackett, Lead Director, Capital One Financial Corporation
- Bonnie Hill, Lead Director, The Home Depot
- Bob Kidder, Lead Director, Morgan Stanley
- Linda Fayne Levinson, Alumnus Member, Former Lead Director, NCR Corporation
- Alex Mandl, Lead Director, Dell; Non-Executive Chairman, Gemalto
- Ellen Marram, Lead Director, Eli Lilly; Presiding Director, Ford Motor Company
- Mike Rose, Presiding Director, General Mills
- Ed Rust, Presiding Director, Caterpillar; Lead Director, McGraw-Hill Companies
- Tom Wajnert, Non-Executive Chairman, Reynolds American

The following general counsel participated in the meeting:

- Sheila Cheston, General Counsel, Northrop Grumman Corporation
- Jennifer Daniels, General Counsel, NCR
- John Finneran, General Counsel, Capital One Financial Corporation
- Eric Grossman, Chief Legal Officer, Morgan Stanley
- Mark Hacker, General Counsel, Motorola Solutions
- J. Kelley, Chief Legal Officer, Equifax
- Bruce Kuhlik, General Counsel, Merck
- Tom Moriarty, General Counsel, CVS Caremark
- Rick Palmore, General Counsel, General Mills
- Teresa Roseborough, General Counsel, The Home Depot

The following network members took part in pre-meeting discussions:

- Ray Gilmartin, Alumnus Member, Former Presiding Director, General Mills
- Ed Kangas, Non-Executive Chairman, Tenet Healthcare; Lead Director, United Technologies
- Dan Schulman, Non-Executive Chairman, Symantec Corporation

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- Stephanie Shern, Presiding Director, GameStop
- Wes von Schack, Lead Director, Bank of New York Mellon and Edwards Lifesciences

The following general counsel took part in pre-meeting discussions:

- Charlie Gill, General Counsel, United Technologies
- John Parker, General Counsel, Coca-Cola Enterprises
- Jane Sherburne, General Counsel, Bank of New York Mellon

The following King & Spalding attorneys participated in all or some of the meeting:

- Mike Egan, Partner; Co-Chair, Mergers and Acquisitions Practice
- Judy O'Brien, Partner; Chair, Emerging Company Practice Group
- Michael Smith, Partner; Co-Chair, Securities Litigation Group
- Chris Wray, Partner; Chair, Special Matters and Government Investigations Practice Group