Cervantes Meets Sarbanes-Oxley

By Peter H. Ehrenberg and James E. Myers of Lowenstein Sandler

If Cervantes were writing Don Quixote today, he might very well place his protagonist in the modern-day board room. Rather than "tilting at windmills," Don Quixote could have been assigned the task of serving as an independent director at a public company. Armed with little more than their own common sense, today's independent directors must fight their way through battles against corporate bureaucracies, prosecutors, regulators and private attorneys.

While there is no single set of rules that would respond to all of the seemingly impossible issues that confront a director of a public corporation, we believe that an independent director should, at a minimum, take the following steps:

Limit committee assignments and volunteer only in areas where the director has relevant expertise. Just as nature abhors a vacuum, volunteers are more than welcome on boards. Members of boards should be careful to withstand the urge to be "good guys" and instead focus on their areas of expertise. In a litigious society, directors may be second-guessed for decisions they make, regardless of the procedural and substantive protections designed for well-meaning directors.

Seek clarification and definition of responsibilities. Directors have fiduciary duties to the shareholders of their corporations. Unfortunately, it is nearly impossible to give a specific definition or to outline all aspects of the concept of "fiduciary responsibility." Directors can control this risk by requesting that counsel clarify their director's responsibilities with respect to specific matters presented to the board. Thus, for example, if a board were considering an acquisition, it would be appropriate for a board member to ask counsel to outline the steps that board members should take before voting on the transaction. Once those steps were outlined, directors might find that additional guidance would available when they ask follow-up questions.

Ensure that committee responsibilities are clearly defined in the corporation's governing instruments. Board committees are created by boards of directors and represent a delegation of responsibilities by the boards to the applicable committees. The responsibilities of the committee are reflected either in board resolutions or in committee charters established by the full board. Directors should take care to ensure that charter documents and board resolutions define their duties.

Develop annual agendas. Independent directors are typically asked to serve on several board committees. To ensure that board committees meet their responsibilities (as reflected in committee charters), directors would be well-advised to request counsel to map out in advance the agenda items for an entire year, so that committee members can be assured that in a one-year cycle, they will perform each of the tasks assigned to them in their charters. One of the items in the agenda for the last meeting of the year should be a report from counsel confirming that each of the assigned tasks has been addressed.

Prioritize issues. Board members, in general - and independent directors, in particular - face numerous issues during a yearly cycle. Given the other demands placed upon independent directors in connection with their primary occupations, it is important for independent directors to understand their corporation's mission critical objectives. Independent directors accordingly should request management to prioritize matters being brought to the attention of the board or the applicable committee. Absent prioritization, board members may spend a disproportionate amount of their time focusing on issues that, in the end, are easily resolvable. A misallocation of attention, in turn, may result in board members' not devoting sufficient time to the most critical issues confronting them.

Ensure that monitoring is effective. Recent case law has taken boards to task for failing to monitor problems once they are identified by management. Once an issue has been identified as a priority, directors should require management to provide periodic reports until the matter has been resolved to the board's satisfaction. Indeed, a portion of each meeting's agenda may be devoted to follow-up reports on issues discussed at prior meetings.

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Governance Ratings

Institutional Shareholder Services rates 5,500 U.S. companies on a range of criteria to assess the strength of their corporate governance. This table shows in which areas companies were most active in adjusting governance policy over the last month. Data for the chart was provided by Institutional Shareholder Services Inc. For more information on CGQ click here (www.issproxy.com)

CGQ Rating Criteria	Aug. %	July %	Change from July to Aug.
Greatest Governance Rating Criteria Increases			
One or more director (but less than a majority of the board) has participated in an ISS-accredited director education program.	21.1%	19.2%	1.9
A board-approved CEO succession plan is in place.	52.1%	51.2%	0.9
The governance committee met during the past year.	62.3%	61.5%	0.8
The performance of the board is reviewed regularly.	66.5%	65.8%	0.7
One or more of the audit committee members are financial experts.	81.0%	80.4%	0.6
Greatest Governance Rating Criteria Decreases			
The company's option plans do not expressly permit repricing.	76.3%	77.7%	-1.4
There are no financial experts on the audit committee.	9.8%	10.4%	-0.6
Board does not have its own outside advisors.	5.6%	6.1%	-0.5
Governance guidelines have been disclosed, but not on the company's Web site.	1.0%	1.5%	-0.5
Outside directors do not meet without the CEO present.	39.5%	39.9%	-0.4
Changes in Board Composition			
Board controlled by a majority of insiders and affiliated outsiders.	9.0%	9.2%	-0.2
Board controlled by a majority of between 50% and 67% independent outsiders.	37.5%	37.4%	0.1
Board controlled by a supermajority of between 67% and 75% independent outsiders.	11.0%	11.1%	-0.1
Board controlled by a supermajority of between 75% and 90% independent outsiders.	15.7%	15.6%	0.2
Board controlled by a supermajority of over 90% independent outsiders.	4.5%	4.5%	0
Board has only one non-independent director (applies to boards with less than 10 members)	22.3%	22.2%	0.1

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Go back to the basics. Directors must avoid being inundated by too much information. Since independent directors have only a finite amount of time for companies they serve, it is important for independent directors to make sure that management provides them with concise reports several days before any meeting is scheduled. Directors who miss a meeting would be well-advised to seek copies of minutes for those meetings shortly after they occur.

In a simpler, less litigious world, the role of the independent director could be satisfied merely by the exercise of common sense. However, as more attention is focused on the board room and more responsibility is imposed on independent directors, it is important for them to assure that good corporate procedures are in place. We believe that the ground rules outlined above will help.

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