SPECIAL REPORT

CORPORATE GOVERNANCE

Assessing the value of regulatory reform

sponsored by:

Bracewell & Giuliani LLP
Jardine Lloyd Thompson Limited
McKenna Long & Aldridge LLP

FINANCIER WORLDWIDE corporatefinanceintelligence

a fiduciary or executive responsibility, inclusion of certain individuals in such information streams has the potential to involve them in distractions and impair their value to the organisation. Two factors are at play here.

First, the perception that principles of accountability are fulfilled by executive command of details has been fostered at least in part by concerns for good governance, best practices, and accountability. With these concerns and the implementation of compliance programs has come a resultant flow of information intended to evidence management's grasp of details for an array of reports, certifications, and discussion and analysis material to the organisation.

A second factor is the facility with which electronic information is transmitted. With the demise of carbon paper and the acceleration of electronic communications, far less deliberation goes into the selection of individuals who will receive an array of communications. The simpler era of deliberate, manual communication has been overtaken and supplanted by technological advances. From casual one-line messages (however unfaithful to conventions of structure, grammar, and spelling), to highly confidential elaborate reports, communication has been simplified to the intentional or unwitting, thoughtful or haphazard, pressing of a 'send' button. Leaving aside the potential for mistaken inclusion – however real, embarrassing, and damaging such transmittals may be – there is a clear but controllable risk that high level individuals within an organisation will become recipients of information they should not have.

There are legal consequences when a trail of communications leads to the door – or email address – of an individual having organisational fiduciary or executive responsibilities but no particular need, desire, or interest in knowing the content of a communication. Receipt of unnecessary information may weigh as more than an annoyance or distraction. Once delivery is confirmed, a recipient is hard pressed to deny receipt of information, and once receipt is acknowledged an explanation of use or action may be expected. Simply put, for some individuals there may be a negative value in receiving information or merely appearing on a list of distributees. As a consequence, documentation listing numerous individuals addressed or copied on electronic communications may become more valuable to an outsider pursuing a litigation agenda against the organisation than the underlying content of the transmitted information ever was to several incidental recipients of the initial message.

Incorporating upstream control of information into the calculus of risk management and compliance activities allows organisations to insulate key personnel from becoming embroiled in legal proceedings that otherwise would be of no interest or concern to them. As a component of its risk management and compliance programs, an organisation may do well by implementing offensive shields to upward dissemination of information as thoughtfully as it constructs restraints that protect against prohibited disclosure and access. In other words, upstream control may be every bit as important as downstream, lateral, and external controls, albeit for different sound reasons. ■

Allen B. Roberts is a partner and co-chair of the Corporate Governance and Compliance sub-practice group at Epstein Becker & Green, P.C.

INTERNAL PROCESSES

Hiring your first independent director from the United States

BY WILLIAM G. CONNOLLY

Whether you are a private company in the US searching for your first independent director or a firm formed in another jurisdiction but growing in the US and hoping to add an independent US director, you do not want to scare away qualified candidates by not understanding their concerns. Volunteering the information necessary to enable candidates to evaluate a board position will make the recruitment process faster and more successful. Director candidates no longer evaluate board opportunities based on the social connections of other board members or their friendship with company principals. Given the high profile corporate governance scandals and resultant enhanced board requirements, US board of director candidates, now more than ever, perform due diligence on the company and board position before agreeing to serve. Sophisticated companies anticipate this and facilitate the due diligence process for candidates as part of the recruitment process.

A senior officer should reach out to a candidate and provide an overview of the company's business, prospects, opportunities and challenges and offer at least the information described below to assist the candidate in his or her decision. The candidate should be provided adequate time to evaluate the company, its board, the protections provided to directors and the burdens of serving. It is good practice to require that a confidentiality agreement be signed by the candidate before sensitive company information is provided and candidates will accept this as routine. After a confidentiality agreement has been signed, the company should provide a board candidate with a number of items, as described below.

First, the company should provide the candidate with a copy of the company certificate of incorporation, bylaws, compliance and ethics plan and any other agreements (such as an indemnification agreement) that protect directors or describe the board structure. A candidate will evaluate the applicable law (the law of the jurisdiction in which the company was formed) for potential director liability (i.e., legal limits on indemnification and exculpation and history of finding directors personally liable), and review the documents for exculpation provisions (insulating directors from personal liability to the company or its shareholders), mandatory indemnification provisions (requiring the company to indemnify directors in certain circumstances) and discretionary indemnification provisions (permitting the company to indemnify directors in certain circumstances). This review may prompt an interested candidate to suggest improvements to these documents or request that the company agree to indemnify the director by contract.

Second, the company should provide the candidate with a copy of its directors' and officers' insurance policy with the name of the insurer, the policy limits and a contact to assist the candidate in understanding the policy details. A candidate will evaluate the amount of coverage and who else can make claims under the policy (i.e., if the corporation itself is covered for its indemnification obligations or claims brought against the corporation, such claims could use up coverage available for directors). The candidate should also be provided with details of any supplemental insurance for directors such as coverage exclusively for directors and officers (not the ▸▸

company) or independent director insurance (a policy covering only the independent directors).

Third, the company should provide the candidate with an explanation of the structure and operating procedures of the board of directors. The candidate will have questions such as: Does the company adhere to the corporate governance requirements of a particular exchange? Will a majority of the board be independent directors? What are the board's standing committees? Does the board have independent advisers? Who are the other directors? Why was the candidate selected and what role is anticipated for the candidate on the board? Do the chief financial officer and the general counsel report directly to a board committee? Who are the company auditors and does the company rotate auditors? How are officer compensation decisions made? What is the company's history of litigation or regulatory disputes? How has the ethics and compliance program been implemented?

Fourth, the company should provide the candidate with copies of all recent company financial statements, public filings and disclosure statements and an understanding of the company ownership structure. A schedule of board and board committee meetings should be provided to the candidate, so that the time commitment necessary to fulfill board duties can be estimated. A candidate should be told if the company will soon be facing issues that could increase the director's time commitment or potential personal liability, such as: raising capital, acquisitions, dispositions, insolvency, conflict of interest transactions or significant disputes.

Finally, the company should provide the candidate with an opportunity to confer with present and past directors, officers, auditors and advisors both before accepting the position and while a director. It could be helpful to set up a meeting for a potential candidate to meet some of these people and ask questions.

Members of the board of directors can be great resources for a company. But the best candidates have many opportunities and are reluctant to expose themselves to potential personal liability. Therefore, companies must approach US independent board of director candidates with an understanding of their concerns and provide the information the candidate needs to become comfortable accepting the position. ■

William G. Connolly is a corporate partner at Riker Danzig Scherer Hyland & Perretti LLP.

The delicate science of compliance

BY MICHAEL LEA

For companies that do business internationally, a global directors' and officers' liability coverage may once have provided its risk managers with a neat solution. In today's more demanding environment, when businesses are keen to establish a presence in the world's emerging economies but corporate decisions are subject to much keener scrutiny, a global D&O policy is beginning to present more problems than solutions.

What is the reason? A combination of factors, with differing local jurisdictions and the idiosyncrasies of the law in a number of countries, is at the heart of many of them. In the Nordic regions, it is by no means the norm for companies to offer to indemnify their directors against alleged wrongful acts. So a D&O policy for this region cannot be written with the assumption that indemnification will take place.

In France, insurers are not able to write D&O on its usual 'claims made' basis and must instead offer something akin to a 'losses occurring' coverage. In Italy, costs must be in addition to the limit of indemnity instead of being part of it, with a similar requirement imposed in Israel.

Changes to Romania's corporate law late last year made it compulsory for companies to purchase D&O insurance, including subsidiaries incorporated in Romania and firms with a non-Romanian parent, and other Eastern European countries are likely to follow its lead.

And in the five years since Sarbanes-Oxley was enacted in the US, there is a worldwide trend to codify what exactly a director's duties are, which in turn will increase the level of exposure to lawsuits, and determine the level and breadth of insurance deemed appropriate for directors to carry.

The heart of the matter

The debate on whether D&O policies comply with this mounting list of differing requirements has generated more heat than light. What's more, it has tended to obscure the main purpose of a D&O policy, which is to ensure that the cover is fully responsive to the needs of the company directors and senior management that it protects and addresses the duties imposed upon them by local law.

This remains the most vital issue – how does your company continue to attract and retain the best candidates in countries where they may suspect that a global D&O cover is no longer adequate? Take Brazil as an example. Since directors' duties were codified in 2004, individuals have become keenly aware of their potential exposures at law. So they will demand to know what level of indemnification their company provides and how the D&O policy will respond in the event of a claim.

However, other issues have intervened, such as those of local regulation and admitted versus non-admitted carriers, which some have taken to be more important. They have certainly acted as obstacles to the concept of a global policy provided by a single insurer. In Latin America, China and India, the law maintains that the insured cannot have the benefit of payment from a non-admitted carrier in the region. Cover must either be reinsured through a local admitted carrier or provided by the local market. Brazil insists that a D&O policy cannot provide indemnification unless cover is provided by the local market and reinsured by the state-owned IRB Brasil Resseguros.

So a worldwide cover provided by a global carrier may involve having 10 or even 20 different policies, many of them tied in with local reinsurers. Only a handful of major insurers – AIG, ACE, Allianz, Chubb, Zurich and Lloyd's – have a comprehensive network of local companies worldwide that they can use as admitted carriers, without recourse to other insurers.

The issue of taxation can also be problematic. A global D&O policy providing indemnification for directors in Australia or Canada, for example, will provoke questions from the tax authorities on the proportion of the overall premium applicable to that country and the tax payable on it. Accurately quantifying the exposure in these countries may not be easy.

The right approach

The D&O market has devised some solutions to these problems of compliance. AIG last year launched its Passport product, under which local policies are tied in with the limit ▸▸